

***United States Court of Appeals
for the
District of Columbia Circuit***



**TRANSCRIPT OF
RECORD**

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Court of Appeals of the District of Columbia

APRIL TERM, 1934.

No. 6227

554

JAMES McDONALD, PETITIONER,

vs.

**GUY T. HELVERING, COMMISSIONER OF
INTERNAL REVENUE.**

APPEAL FROM THE BOARD OF TAX APPEALS.

FILED MAY 17, 1934.

FILED JUNE 25, 1934.

Court of Appeals of the District of Columbia

APRIL TERM, 1934.

No. 6227

JAMES McDONALD, PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE,
RESPONDENT.

ON PETITION TO REVIEW THE DECISION OF THE UNITED
STATES BOARD OF TAX APPEALS.

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Court of Appeals of the District of Columbia

No. 6227.

JAMES McDONALD, Petitioner,

vs.

GUY T. HELVERING, Commissioner of Internal Revenue.

1

Docket No. 52329.

JAMES McDONALD, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Appearances:

For Petitioner: Wm. F. Norman, Esq., Oscar W. Underwood, Esq., H. C. Kilpatrick, Esq.

For Respondent: M. M. Mahany, Esq.

Docket Entries.

1931.

Jan. 29. Petition received and filed. Taxpayer notified.
(Fee paid.)

Jan. 29. Copy of petition served on General Counsel.

Feb. 27. Answer filed by General Counsel.

Mar. 3. Copy of answer served on taxpayer—General Calendar.

1932.

Feb. 10. Notice of the appearance of O. W. Underwood and H. C. Kilpatrick, counsel for taxpayer, filed.

Oct. 5. Hearing set Nov. 3, 1932.

Nov. 3. Hearing had before Mr. Sternhagen on merits. Submitted. Stipulation of facts filed. Petitioner's brief due Jan. 2, 1933, (private exchange), Respondent's brief due Jan. 2, 1933, (Private exchange)—reply, if any, Jan. 16, 1933.

Nov. 16. Transcript of hearing of Nov. 3, 1932 filed.

Dec. 22. Brief filed by General Counsel.

Dec. 30. Brief filed by taxpayer.

1933.

- Jan. 12. Reply brief filed by taxpayer.
- Apr. 24. Motion for leave to file amended petition filed by taxpayer—amended petition lodged. 4/26/33 granted. 5/2/33 copy served on General Counsel.
- Aug. 22. Findings of fact and opinion rendered—John M. Sternhagen, Division 10. Judgment will be entered for the respondent.
- Aug. 25. Judgment entered—J. M. Sternhagen, Division 10.
- Sept. 9. Motion to withdraw judgment entered 8/25/33 and settle under Rule 50, filed by taxpayer.
- Sept. 13. Order vacating judgment entered.
- Sept. 13. Order modifying opinion entered.
- Oct. 19. Notice of settlement filed by General Counsel.
- Oct. 21. Hearing set Nov. 8, 1933 on settlement.
- Nov. 7. Consent to settlement filed by taxpayer.
- Nov. 13. Judgment entered—J. M. Sternhagen, Division 10.

1934.

- Feb. 5. Motion to fix amount of bond filed by taxpayer.
- Feb. 6. Stipulation of venue filed.
- Feb. 12. Supersedeas bond in the amount of \$8,000.00 approved and ordered filed.

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- Feb. 12. Petition for review by Court of Appeals for D. C. with assignments of error filed by taxpayer.
- Feb. 12. Proof of service filed by taxpayer.
- Mar. 22. Stipulation to omit amended petition and exhibit from the record filed.
- Apr. 6. Præcipe filed—proof of service thereon.
- Apr. 9. Agreed statement of evidence approved and ordered filed.
- Apr. 13. Order enlarging time to May 30, 1934 to transmit and deliver record entered.

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Filed Jan. 29, 1931.

United States Board of Tax Appeals.

Docket No. 52329.

JAMES McDONALD, Petitioner,

VS.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Petition.

To the Honorable Members of the Board of Tax Appeals:

Your petitioner, James McDonald, respectfully represents:

I. That your petitioner is an individual and a citizen of the United States, residing at Hailey, Idaho.

Jurisdiction of the Board.

II. That subsequent to the enactment of the Revenue Act of 1926, and within sixty days of the filing hereof, to-wit, on December 1, 1930, the Respondent mailed to your petitioner a notice of deficiency of income taxes alleged to be due by your petitioner for the year 1927; that a copy of said notice is attached hereto, marked Exhibit No. 1, and made a part hereof; and that your petitioner appeals from the findings of the Respondent set forth in said deficiency notice.

Nature of Deficiency.

III. That the amount of said alleged deficiency is \$12,681.70; that the nature of the deficiency is income taxes for the year 1927, and that the entire amount is in controversy.

Assignments of Error.

IV. That the Respondent erred as follows:

(1) The Respondent erred in including in the gross income of the petitioner for the year 1927, the sum of \$25,000.00, representing an amount paid by the Fulton Trust Company of New York to Mrs. Beulah Martin, formerly the

wife of the petitioner, pursuant to an irrevocable assignment which petitioner made to said Beulah Martin of his interest in the estate of James McDonald, deceased.

(2) The Respondent erred in including in the gross income of the petitioner for the year 1927, the sum of \$11,000.00, representing an amount paid by the Fulton Trust Company of New York to Mrs. Thaona Aveline McDonald, formerly the wife of the petitioner, pursuant to an irrevocable assignment which petitioner made to said Thaona Aveline McDonald of his interest in the estate of James McDonald, deceased.

(3) The Respondent erred in disallowing a deduction of \$10,000.00 for the year 1927, representing attorney's fees paid to William F. Norman.

(4) The Respondent erred in adding to the gross income of the petitioner for the year 1927 the sum of \$25,000.00, representing one-half of a commission of \$50,000.00 which the Fulton Trust Company and Joseph S. Graydon, trustees, repaid to the estate of James McDonald, deceased, during the said year.

Statement of the Facts.

V. That your petitioner relies upon the following facts:

(1) Prior to the year 1927 the petitioner entered into an agreement with Beulah Martin, his former wife, with respect to their property rights, whereby he agreed to pay her the sum of \$400,000.00. In order to take care of said payment the petitioner made an irrevocable assignment to his said former wife, Beulah Martin, of his right, title and interest in a certain portion of the estate of James McDonald, deceased, of which the petitioner was one of the beneficiaries. Pursuant to said irrevocable assignment, the trustees of said estate paid to the said Beulah Martin during the year 1927 the sum of \$25,000.00. The Respondent added said sum of \$25,000.00 to the gross income of the petitioner, but petitioner contends that no part thereof represented income to him during the year 1927, for the reason that no part thereof was paid over to or received by him and the petitioner had no interest whatsoever in said amount during said year 1927.

(2) On or about January 17, 1927, the petitioner entered into an agreement with Thaona Aveline McDonald, his wife, with respect to the settlement of their property rights,

whereby he irrevocably assigned to her the sum of \$200,000.00 of his interest in the estate of James McDonald, deceased. Pursuant to said irrevocable assignment, the trustees of the estate of James McDonald, deceased, paid to the said Thaona Aveline McDonald the sum of \$11,000.00 during the year 1927. The Respondent added said sum of \$11,000.00 to the gross income of the petitioner, but petitioner contends that no part thereof represented income to him during the year 1927, for the reason that no part thereof was paid over to or received by him and the
7 petitioner had no interest whatsoever in said amount during said year 1927.

(3) In connection with the drafting of the settlement agreement between the petitioner and his wife, Thaona Aveline McDonald, the latter employed as her attorney, William F. Norman. Under the terms of said settlement agreement, the petitioner agreed to pay and did pay, in the year 1927, \$10,000.00 to the said William F. Norman, as attorney's fees for representing the said Thaona Aveline McDonald. The Respondent refused to permit the petitioner to deduct said amount from his gross income for the year 1927, and petitioner claims that he is entitled to deduct said amount.

(4) Prior to the taxable year of 1927, the trustees of the estate of James McDonald, deceased, paid to themselves out of the corpus of the said estate, a commission amounting to \$50,000.00 on stock dividends received by said estate. The action of said trustees was contested by the beneficiaries, including petitioner, and the Supreme Court of the United States held, in the case of James McDonald, Jr. et al, vs. Lawrence Maxwell and Fulton Trust Company, Executors, 274 U. S. 91-99, that the payment of said commission by the trustees to themselves was illegal and ordered the trustees to repay said commission to the
8 corpus of said estate of James McDonald, deceased.

Pursuant to said order the trustees repaid said commission of \$50,000.00 to the corpus of the said estate during the year 1927. On the erroneous theory that the repayment of said commission represented income to the estate to which the petitioner was entitled to one-half, the Respondent added \$25,000.00 of said commission of \$50,000.00 to the income of the petitioner for the year 1927. Petitioner contends that the repayment of said commission of

\$50,000.00 to the estate of James McDonald, deceased, in 1927 did not represent income to the petitioner during said year.

Wherefore, your petitioner prays this Honorable Board to review said findings and determination of said deficiency by the Respondent, to reverse and set aside the same and to redetermine the deficiency.

JAMES McDONALD,
By WILLIAM F. NORMAN,
Attorney for Petitioner,
835 Southern Building,
Washington, D. C.

9 CITY OF WASHINGTON,
District of Columbia, ss:

William F. Norman, being first duly sworn, deposes and says that he is the attorney for the above named petitioner, duly authorized in the premises; that he has read the foregoing petition by him subscribed and knows the contents thereof; and that the facts therein stated he verily believes to be true.

WILLIAM F. NORMAN.

Subscribed and sworn to before me this the 28th day of January, A. D. 1931.

[Seal of Beryl W. Roberts, Notary Public, District
of Columbia.]

BERYL W. ROBERTS,
Notary Public in and for
the District of Columbia.

My commission expires Jan. 7, 1933.

10 EXHIBIT No. 1.

Treasury Department, Washington.

December 1, 1930.

Mr. James McDonald,
c/o William F. Norman,
Southern Building,
Washington, D. C.

SIR:

You are advised that the determination of your tax liability for the year 1927 discloses a deficiency of \$12,681.70, as shown in the statement attached.

In accordance with section 274 of the Revenue Act of 1926, notice is hereby given of the deficiency mentioned. Within sixty days (not counting Sunday as the sixtieth day) from the date of the mailing of this letter, you may petition the United States Board of Tax Appeals for a redetermination of your tax liability.

However, if you do not desire to petition, you are requested to execute the enclosed agreement form and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7. The signing of this agreement will expedite the closing of your return by permitting an early assessment of any deficiency and preventing the accumulation of interest charges, since the interest period terminates thirty days after filing the enclosed agreement, or on the date assessment is made, whichever is earlier; whereas if no agreement is filed, interest will accumulate to the date of assessment of the deficiency.

Respectfully,

DAVID BURNET,

Commissioner,

By J. C. WILMER,

Deputy Commissioner.

Enclosures: Statement, Form 882, Form 870.

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Statement.

IT:AR:A-1. LWB.

In re Mr. James McDonald, c/o William F. Norman, Southern Building, Washington, D. C.

Tax Liability.

Year.	Corrected tax liability.	Tax previously assessed.	Deficiency.
1927	\$14,494.07	\$1,812.37	\$12,681.70

The report of the internal revenue agent in charge, Baltimore, Maryland, covering an examination of your return has been reviewed and approved with the following exception:

Information now on file in this office discloses that the income of the trust created under the will of your father, James McDonald, The Fulton Trust Company of New York,

Trustees, has been increased by \$50,000.00 representing commissions which the court ordered to be returned to the trust.

It is held that as a beneficiary of the above-named trust you were entitled to one-half of the income of the trust. One-half of the additional income of \$50,000.00, or \$25,000.00, has therefore been added to your taxable income.

Careful consideration has been given to the information submitted in your protest to this office on September 5, 1930, and to the information submitted at the conferences in this office on August 18, 1930 and September 22, 1930.

Computation of Tax.

Net income shown on your return.....	\$40,112.46
Add:	
1. Deduction disallowed	46,000.00
2. Additional income from trustees.....	25,000.00
Corrected net income	\$111,112.46
12 Brought forward	\$111,112.46
Less:	
Dividends	\$90,552.30
Personal exemption	3,500.00
	<u>94,052.30</u>
Amount subject to normal tax.....	\$17,060.16
Normal tax at 1½% on \$4,000.00.....	60.00
Normal tax at 3% on \$4,000.00.....	120.00
Normal tax at 5% on \$9,060.16.....	453.01
Surtax on \$111,112.46	13,882.49
Total	\$14,515.50
Less:	
Credit for earned net income.....	\$5.63
	<u>21.43</u>
Tax liability	\$14,494.07
Tax previously assessed	1,812.37
Deficiency	\$12,681.70

Explanation of Changes.

1. The deduction of \$46,000.00 claimed on your return has been disallowed as representing a personal expense. This adjustment has been fully explained in the revenue agent's report, a copy of which has been sent you.

2. This item represents additional income from the Fulton Trust Company, Trustees, and has been previously explained.

A copy of this letter has been sent to your duly appointed representative, Mr. William F. Norman, Southern Building, Washington, D. C.

Payment should not be made until a bill is received from the collector of internal revenue for your district, and remittance should then be made to him.

13 [Stamp:] United States Board of Tax Appeals.
Filed Feb. 27, 1931.

United States Board of Tax Appeals.

Docket Number 52329.

JAMES McDONALD, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Answer.

The Commissioner of Internal Revenue, by his attorney, C. M. Charest, General Counsel, Bureau of Internal Revenue, for answer to the petition of the above-named taxpayer, admits and denies as follows:

I. Admits that the petitioner is an individual and a citizen of the United States and denies any knowledge or information sufficient to form a belief as to the truth of the remaining allegations of Paragraph I and therefore denies the same.

II. Admits the allegations contained in Paragraph II.

III. Admits the allegations contained in Paragraph III.

IV. Denies that he erred in determining the tax set forth in said notice of deficiency and further denies that he erred as alleged in Paragraphs IV(1), IV(2), IV(3) and IV(4) of the petition.

V. Denies each and every material allegation contained in Paragraphs V(1), V(2), V(3) and V(4) of the petition which is inconsistent with or contrary to the determination

of the respondent as set forth in the statement accompanying the notice of deficiency, which is attached to and made a part of the taxpayer's petition, as Exhibit A.

VI. Denies generally and specifically each and every material allegation contained in taxpayer's petition not hereinbefore admitted, qualified or denied.

Wherefore, it is prayed that the taxpayer's appeal be denied.

(Signed)

C. M. CHAREST,
General Counsel,
Bureau of Internal Revenue.

Of Counsel:

JOHN H. PIGG,
Special Attorney,
Bureau of Internal Revenue.

k 2-25-31.

14 [Stamp:] United States Board of Tax Appeals.
Filed Apr. 24, 1933.

[Stamp:] Granted Apr. 26, 1933. (Signed) John M. Sternhagen, Member U. S. Board of Tax Appeals.

United States Board of Tax Appeals.

Docket No. 52329.

JAMES McDONALD, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Motion.

Comes now the petitioner, by his counsel, and moves the Board for leave to file the annexed amended petition.

In support of this motion, petitioner shows unto the Board as follows:

The original petition herein was verified by the affidavit of William F. Norman, who was duly authorized by petitioner to prepare and file the petition herein, and it is understood that at the time of filing of said petition Mr. Norman notified the Board that a petition duly verified by

petitioner would be filed shortly thereafter. This matter was apparently overlooked by the attorney in question. He died on or about August 12, 1931. This amended petition is therefore being filed to comply with the Board's rules.

Respectfully,

OSCAR W. UNDERWOOD, JR.,

H. C. KILPATRICK,

717 Southern Bldg., Washington,

Counsel for Petitioner.

15 [Stamp:] United States Board of Tax Appeals.
Filed Mar. 22, 1934.

United States Board of Tax Appeals.

Docket No. 52329.

JAMES McDONALD, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Stipulation of Counsel.

Whereas, the amended petition filed herein pursuant to motion filed April 24, 1933, and order entered April 26, 1933, is in words and figures identical with the petition filed January 29, 1931, except that said amended petition is signed by Oscar W. Underwood, Jr., and H. C. Kilpatrick as counsel for petitioner, and verified by James McDonald under date of April 18, 1933; and whereas each of said petitions has annexed thereto as Exhibit No. 1 a
16 true and correct copy of the deficiency notice of December 1, 1930, with attached "Statement";

It is hereby agreed by the parties hereto, by their respective attorneys, that the Clerk of the Board of Tax Appeals, in preparing and certifying to the Clerk of the Court of Appeals of the District of Columbia the documents required by the rules of that Court, may transmit copies of this stipulation, and of the original petition filed January 29, 1931, with the exhibits thereto attached, and shall not

transmit a copy of said amended petition or the exhibit thereto attached.

OSCAR W. UNDERWOOD, JR.,
H. C. KILPATRICK,

Attorneys for Petitioner.

(S.) ROBERT H. JACKSON,
*General Counsel,
Bureau of Internal Revenue,
Attorney for Respondent.*

17 United States Board of Tax Appeals.

JAMES McDONALD, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Docket No. 52329. Promulgated August 22, 1933.

An agreement by the petitioner to pay his wife a sum of money in full settlement of property rights arising out of the marriage relation, providing for payment in part out of the petitioner's share, as beneficiary, of future income of an estate, *held* not to constitute an assignment of part of the petitioner's right to the income, but a mere agreement to pay out of income which first became income of the petitioner; and amounts paid by the trustees to his wife, pursuant to the agreement, were properly included in the income of the petitioner.

H. C. Kilpatrick, Esq., for the petitioner.

Maxwell M. Mahany, Esq., for the respondent.

This is a proceeding for the redetermination of a deficiency of \$12,681.70 in income tax for 1927. The only issue involved is whether the amount of \$25,000, paid during 1927 to the petitioner's wife by the trustees of an estate of which petitioner was a beneficiary, pursuant to certain agreements between the petitioner and his wife, was properly included in the gross income of the petitioner. Other issues raised by the amended petition have been disposed of by stipulation of counsel.

Findings of Fact.

1. The petitioner is an individual and a resident of Hailey, Idaho. The petitioner and his wife, Beulah B.

McDonald, were married on April 17, 1912. They have two sons, namely, James McDonald, Jr., born September 10, 1913, and Robert Alexander McDonald, born May 12, 1915, both of whom are living.

2. The petitioner's father, James McDonald, died January 13, 1915, a resident of the District of Columbia, leaving a will executed on June 26, 1913, in London, England, and a codicil thereto executed on April 13, 1914, in New York City. The will and codicil were admitted to probate in the Supreme Court of the District of Columbia on January 20, 1915, and the executors named therein were
18 appointed by the court. By the terms of the will and codicil the estate was to be held by Lawrence Maxwell and the Fulton Trust Co., as executors and trustees, and certain annuities were to be paid until the petitioner's oldest surviving child should reach the age of thirty years, at which time the petitioner was to receive one-half of the estate and the other half was to be distributed to and divided among the children of petitioner, share and share alike.

3. On May 6, 1922, the petitioner brought suit in the District of Columbia to have the will declared void on the ground that it violated the rule against perpetuities. The suit was dismissed by the Supreme Court of the District of Columbia and an appeal was taken to the court of appeals. On December 11, 1924, while the suit and the administration of the estate were pending, the petitioner and his wife entered into a written agreement for the purpose of "fixing, settling, and determining their respective property rights." Each party relinquished to the other all claims and demands except those existing under the agreement, and agreed that the separate property of each should be vested in the respective parties free and clear of any obligations arising from the marriage relation. The petitioner agreed, in the event of a decision in the pending suit adjudging him to be the sole heir of the estate of his father, to assign and transfer for the use of his two sons an undivided one-half interest in all of the estate which he might so inherit, and, in present terms, assigned and transferred such interest, in trust for their use and benefit upon terms not here material. In paragraph 5 he further agreed to transfer to his sons, from his own interest, sums equal to any amounts by which their inheritances might

be decreased by reason of the birth in the future of any children of petitioner who would be entitled to share in the estate under the will; and in paragraph 6 he confirmed a previous assignment to his wife of certain annuities to which he was entitled under the terms of the will. Paragraph 7 provided as follows:

The party of the first part shall and will, in addition to the payments hereinbefore specified, pay to the party of the second part the sum of Four Hundred Thousand Dollars (\$400,000) in lawful money of the United States, in full settlement of all claims and demands of every kind or character now existing or which but for this agreement might hereafter arise. The said payment of Four Hundred Thousand Dollars (\$400,000) by the party of the first part shall be made to the party of the second part when the party of the first part becomes entitled to his share of the estate of James McDonald, Sr., whether he shall become so entitled thereto pursuant to the provisions of said last will and testament of James McDonald, Sr., deceased, or as his heir at law, or prior thereto if the said party of the first part so elects. For the purpose of further assuring the payment of said Four Hundred Thousand Dollars (\$400,000) to the party of the second part said party of the first part does hereby assign, transfer and set over to

19 the said party of the second part an interest in his share of the property of the estate of James McDonald, Sr., in the amount of Four Hundred Thousand Dollars (\$400,000) and directs the trustees named in the will of James McDonald, Sr., or their successors, to pay and deliver to the party of the second part, whenever such payment may be by such trustees lawfully made, the said sum of Four Hundred Thousand Dollars (\$400,000), and in the event that the trust provisions of said will shall hereafter finally be declared void or the said party of the first part shall for any other reason succeed to the estate of James McDonald, Sr., then the executor of said last will and testament and the court in which the administration of said estate is then pending are, and such executor and such court is hereby authorized, empowered and directed to cause to be distributed and paid to the said party of the second part the said sum of Four Hundred Thousand Dollars (\$400,000).

4. After December 11, 1924, and prior to December 21, 1925, the petitioner and his wife were divorced, and she resumed her maiden name of Beulah Martin.

5. On December 21, 1925, the petitioner and his former wife entered into a written agreement providing that, in the event the court of appeals should hold that the petitioner and his two sons living at testator's death are the only legatees and certain contingent legatees shall take no interest whatever; and, further, if arrangement is made whereby one-half of the accumulated income then in the hands of the executors and trustees may be paid over to petitioner, and one-half of the income as it accumulates may be paid to petitioner:

1. That all the costs and other expenses incident to the prosecution of said suit in the Supreme Court of the District of Columbia and in the Court of Appeals of said District, including counsel fees of plaintiff, the defendant, Beulah McDonald, and guardian ad litem for said minor defendants be first paid out of the entire accumulated income.

2. And out of the accumulated income payable to James McDonald there will be paid to Beulah Martin the sum of One Hundred Fifty Thousand (\$150,000) Dollars, One Hundred Thousand (\$100,000) Dollars of which is to be applied as a credit on a contract entered into by and between the parties hereto on the 11th day of December, 1924, under the terms of which said Beulah Martin is to be paid Four Hundred Thousand (\$400,000) Dollars. The other Fifty Thousand (\$50,000) Dollars to be in full payment for household furniture, paintings, works of art, etc., heretofore given to the said Beulah Martin by the said James McDonald, said property to be returned to the said James McDonald in the event he cares to exercise the option to re-purchase the same, (this not to include family jewels). In the event said James McDonald does not care to exercise the option to pay Fifty Thousand (\$50,000) Dollars for said property, then the said Beulah Martin is to receive the sum of One Hundred Fifty Thousand (\$150,000) Dollars to be applied as a credit on the Four Hundred Thousand (\$400,000) provided in said contract of December 11, 1924. After the application of the above payment as a credit on said contract, then said Beulah Martin agrees to accept the sum of Twenty-five Thousand (\$25,000) Dol-

lars per year direct to the said Beulah Martin until the balance of said Four Hundred Thousand (\$400,000) is liquidated.

20 3. It is further agreed in the event said decree is entered that said contract of December 11th, 1924, will be novated and reformed by the elimination of all of paragraphs 5, 6 and 7, and the copy of said contract now on file with the Fulton Trust Company of New York will be withdrawn and another contract executed and filed in its stead in accordance with the stipulation herein.

4. The Four Hundred Thousand (\$400,000) Dollar settlement provided in paragraph 7 of said contract of December 11th, 1924, includes a note of Two Hundred Thousand (\$200,000) Dollars heretofore executed by the said James McDonald and payable to Beulah Martin, said note having been executed so that the annual interest thereon would guarantee the payment of the One Thousand (1,000) Dollars per month referred to in paragraph 6 of said contract. Upon the execution of said settlement as herein outlined, said One Thousand (\$1,000) Dollars per month will cease and said note of Two Hundred Thousand (200,000) Dollars will be surrendered by said Beulah Martin to James McDonald.

6. On February 2, 1926, petitioner entered into a written agreement with said Beulah Martin, which, after reciting the making of the agreement of December 21, 1925, provided as follows:

Further negotiations looking to the settlement of the suit now pending on appeal in the Court of Appeals of the District of Columbia involving the validity of the Will of James McDonald, Sr., referred to in such memorandum of agreement, have shown that "the entire accumulated income" possibly cannot be applied to the payment of costs and other expenses incident to the prosecution of said suit, but that there can possibly be used for said purposes only the one-half of such entire accumulated income that will be awarded to James McDonald, Jr., as a result it may become necessary to modify and amend paragraphs 1 and 2 of such memorandum of agreement. Accordingly, and in such event, paragraph 1 of such agreement will be modified and amended to read as follows:

That such costs as may be adjudged against James McDonald in the Supreme Court of the District of Columbia and in the Court of Appeals of said District shall be first paid out of the one-half of the said accumulated income to be distributed to the said James McDonald; also the expenses incurred by the said James McDonald in the prosecution of said suit; and the attorneys' fees incurred by the said James McDonald in the prosecution of the said suit, which shall include Twenty Thousand (\$20,000) Dollars to be paid to U. S. Webb, as attorney for Beulah McDonald (now Beulah Martin) the balance of said fee of said Webb to be paid by the said Beulah Martin.

Paragraph 2 of said memorandum of agreement so signed and executed as aforesaid is hereby modified and amended to read as follows:

And out of the accumulated income payable to James McDonald there will be paid to Beulah Martin the sum of One Hundred Thousand (\$100,000) Dollars, which shall be applied as a credit on a contract entered into by and between the parties hereto on the 11th day of December, 1924, under the terms of which said Beulah Martin is to be paid Four Hundred Thousand (\$400,000) Dollars. After the application of the above payment of One Hundred Thousand (\$100,000) Dollars as a credit on said contract, then said Beulah Martin agrees to accept the sum of Twenty-five Thousand (\$25,000) Dollars per year, without interest, on said contract, until the said total sum of

Four Hundred Thousand (\$400,000) Dollars shall
21 have been fully paid, and an order shall be given to the Fulton Trust Company of New York to make to Beulah Martin the said payments of Twenty-five Thousand (\$25,000) Dollars per year direct to her until the balance of said sum of Four Hundred Thousand (\$400,000) Dollars shall have been fully paid.

Said payments of Twenty-five Thousand (\$25,000) Dollars per year shall be made to Beulah Martin for and during the period of twelve years, unless within that period the one-half of the property of said estate should be delivered to said James McDonald, Jr., and in that event the Fulton Trust Company shall at such date pay to Beulah Martin such sum as will complete the total of Four Hundred Thousand (\$400,000) Dollars.

Paragraphs 1 and 2 as herein amended and modified shall be construed as substituted for paragraphs 1 and 2 as contained in the original memorandum of agreement, and in all other respects said original memorandum of agreement is reapproved and reaffirmed. Executed in duplicate.

7. On May 3, 1926, the court of appeals entered a decree (*McDonald v. Maxwell*, 12 Fed. (2d) 822) as follows:

(1) That upon the death of the testator, James McDonald, the appellant, James McDonald, Jr., took a present vested interest in the undivided one-half of the testator's estate after the payment of debts, specific legacies, annuities, and costs of administration, the corpus thereof to be paid to said James by the executors under the will when his oldest child living at the testator's death shall reach the age of 30 years.

(2) That pending the payment to said James of the principal of his one-half interest in said estate he is entitled to receive, and the said executors and trustees shall pay to him, in addition to the annuity provided for him by the codicil of said will, the cash income upon the said one-half interest accrued thereon to this date and the future cash income thereon from time to time as the same shall accrue hereafter.

(3) That upon the death of the testator, James McDonald, the infant defendant and appellees, James McDonald, 3d, and Robert Alexander McDonald, took a present vested interest in the remaining one-half of the estate of said testator after the payment of debts, specific legacies, annuities, and costs of administration, the same to be divided between them, share and share alike, such division and distribution to be made when the oldest of said children shall reach the age of 30 years, and otherwise provided by the terms of the will.

8. Pursuant to the decree, there was paid to the petitioner in 1926 by the trustees under the will of James McDonald, Sr., deceased, a sum in excess of \$500,000, representing the "cash income upon the said one-half interest accrued thereon to this date," as provided for in the decree. Out of said \$500,000, the petitioner paid to Beulah Martin the \$100,000 in cash, as provided for in paragraph 2 of the agreement of December 21, 1925, as modified by paragraph 2 of the agreement of February 2, 1926.

9. The Fulton Trust Co. and Joseph S. Graydon, as trustees under the will of James McDonald, deceased, for the year 1927 filed a Form 1041 fiduciary return, in which the following was reported:

22	Profit from sale of stocks and bonds	\$6,856.12
	Interest & miscellaneous income	23,544.98
	Dividends	181,104.60
		211,505.70
	Deductions: Taxes, Trustees' Commissions	31,914.23
	Net income	179,591.47

The return indicated the following distribution:

	Dividends.	Balance.
James McDonald, Hailey, Idaho . .	\$90,552.30	(\$4,184.62)
Fulton Trust Co. of New York, trustee for James McDonald 3d and Robert Alex McDonald, 149 Broadway, New York City	90,552.30	(4,184.63)
Fulton Trust Co. of New York and Joseph S. Graydon, Trustees (profits from sale)		6,856.12

The trustees filed a Form 1040 return upon which they reported the \$6,856.12 profit from sale of corpus, and paid a tax thereon. They also filed another Form 1040 under the style "Fulton Trust Company of New York, Trustee for James McDonald 3rd and Robert Alexander McDonald," in which they reported and paid tax on the \$90,552.30 dividends, less the \$4,184.63 one half of the loss accruing to James McDonald 3d and Robert Alexander McDonald. The trustees filed no Form 1040 return on behalf of the petitioner, nor did they pay any tax on the \$90,552.30 dividends, less \$4,184.63 (half of the loss), accruing on the half of the current income distributable to the petitioner.

The petitioner, in filing his income tax return for the year 1927, reported as dividends the sum of \$90,552.30, and deducted the \$4,184.63 loss. Among "Other Deductions" the petitioner deducted the following:

"Division of Income, former wife Beulah Martin \$25,000",

representing that sum which the trustees, pursuant to the provisions of paragraph 2 of the December 21, 1925, and February 2, 1926, agreements above set forth, paid out of the \$90,552.30 to Beulah Martin in that year. The respondent, in arriving at the petitioner's taxable net income for the year 1927, as reflected in the notice of deficiency, disallowed the \$25,000 deduction theretofore taken by the petitioner on his return.

Opinion.

STERNHAGEN :

The sole issue presented for decision is whether the amount of \$25,000 paid to the petitioner's wife in 1927 by the trustees of his father's estate, pursuant to the agreements set forth in the findings of fact, was income of the petitioner. The petitioner says it was not, contend-
23 ing that under the will he was the owner of alienable property in the nature of an equitable estate for years, that the agreements with his wife constituted an irrevocable assignment of an undivided interest in that estate, and that amounts paid to her under such an assignment are not income to him.

The nature of petitioner's interest in the estate is defined by the decree of the Court of Appeals of the District of Columbia, namely, a present vested interest in an undivided one half of the residuary estate, entitling the petitioner to receive one half of the cash income during the life of the trust, and one half of the corpus upon its termination when his oldest child living at the testator's death reached the age of 30 years. *McDonald v. Maxwell*, 12 Fed. (2d) 822. His interest in the income—his right to the income—was an equitable estate for years and present property, alienable at common law like any other, in the absence of restraint on alienation. *Commissioner v. Field*, 42 Fed. (2d) 822; *Edith R. Wood*, 27 B.T.A. 1308; District of Columbia Code, secs. 1, 1017, 1030, 1032, 1036, 1640; *Lisner v. Hughes*, 49 App. D. C. 40. It does not appear that the will imposed any restraint on alienation.

If the agreements in question had the effect of divesting the petitioner absolutely and irrevocably of an undivided part of his equitable estate in the income, the petitioner should prevail. *Commissioner v. Field*, 42 Fed. (2d) 822; *O'Malley-Keyes v. Eaton*, 24 Fed. (2d) 820; *Young v.*

Gnichtel, 28 Fed. (2d) 789; *Edith H. Blaney*, 13 B.T.A. 1315; *Grace Scripps Clark*, 16 B.T.A. 453. This is on the well settled principle that, while an assignment of income does not relieve the assignor of the tax thereon, an assignment of property or property rights does relieve the assignor of the tax on income subsequently arising therefrom, since both the property and the income no longer belong to him. *William Ernest Seatree*, 25 B.T.A. 396; *Hazel T. Power*, 23 B.T.A. 428; *affd.*, 61 Fed. (2d) 625; certiorari denied, 288 U. S. 612; *Bishop v. Commissioner*, 54 Fed. (2) 298.

No contention is made by the petitioner that he assigned any part of his interest in the corpus of the estate, and it is necessary to consider only whether the agreements divested him of part of his interest in the income.

In our opinion, the agreements do not disclose any transfer of the right to receive income. The first agreement of December 11, 1924, as well as the subsequent modifications, was primarily an agreement of the petitioner to pay his wife the fixed sum of \$400,000 in full settlement of any claims on his property which she might have by reason of the marriage relation. When the promise was made the petitioner was assured of part of the estate, either as
24 heir or under the will. The amount was payable only when he became "entitled to his share of the estate", with the right to pay prior thereto if he so elected. To assure payment he in present terms assigned to his wife "an interest in his share of the property of the estate" in the amount of \$400,000. Clearly, the latter provision was not an absolute and irrevocable assignment. If petitioner had elected to pay the full amount from his individual funds prior to settlement of the suit, or if he had paid out of property received from the trustees, the assignment would have become inoperative. Furthermore, the assignment is of part of petitioner's share of the property, and this might be construed to include his share of the corpus rather than of the income.

However this may be, we believe the petitioner's rights must be determined in the light of the 1925 and 1926 agreements. Those agreements were made on the condition, among others, that the court of appeals should adjudge the petitioner to be entitled to one half the accumulated and future income and that an arrangement should be made

whereby petitioner should be paid his share of the then accumulated income and his share of the future income. The conditions happened and the agreements became operative. They provided for payment out of the accumulated income of \$100,000, to be credited on the obligation of \$400,000; "that said Beulah Martin agree to accept the sum of * * * \$25,000 per year, without interest, on said contract [of December 11, 1924] until the said total sum of * * * \$400,000 shall have been fully paid"; and that the payments of \$25,000 per year shall be made for a period of 12 years, but in the event one half of the property or corpus of the estate should be delivered to petitioner within that period, a sum equal to the unpaid balance should be paid to her by the trustee. By express terms these agreements eliminated from the contract of the parties the provision of the December 11, 1924, agreement, assigning an interest in petitioner's "share of the property of the estate" to assure payment of the \$400,000. There are no substituted words of assignment. In our opinion, the petitioner merely promised to make payments to his wife out of distributions to be received by him from the estate. With respect to the payment of \$100,000, this was to be paid "out of the accumulated income payable to James McDonald." No direction was given the trustees to make this payment. They paid over \$500,000 to petitioner, and he in turn paid the \$100,000 to his wife. With respect to the payments of \$25,000 per year, with which we are primarily concerned, there is no specific designation of the source, but it is clear that the parties intended that they should be made out of the petitioner's share of the future income, or, if the trust should terminate within 12 years, that the unpaid

25 balance be paid out of either income or corpus. The entire agreement discloses an intention to make the payments out of income (or property, if the trust terminated before 12 years), which first became income of the petitioner. There is nothing which indicates that petitioner made any transfer or assignment of his right to income. We perceive no material difference between the agreement and that involved in *Marion Stone Burt Lansill*, 17 B.T.A. 413; affd., 58 Fed. (2d) 572. As in that case, the order to the trustees to make the payment direct to petitioner's wife, if it was in fact given, was but a convenient method of payment.

The petitioner urges that the assignment in *Commissioner v. Field, supra*, is almost identical with the agreements here in question. That case is obviously inapplicable. It involved a deed assigning a two-thirds interest "in all the income of [part] of the residuary estate * * * intending hereby to convey to and vest in [the assignee] an undivided two-thirds interest in all the net income adjudicated to belong to [the assignor]." In that case, as well as other authorities relied upon, the assignment was held to effect a complete divestiture of the property interest of the assignor and the income therefrom. This is not the effect of the instruments in question. We hold that the amount of \$25,000 paid by the trustees in 1927 to petitioner's wife was properly included in the income of the petitioner. *Ormsby McKnight Mitchel*, 1 B.T.A. 143, 149; *Mitchell v. Bowers*, 9 Fed. (2d) 414; *affd.*, 15 Fed. (2d) 287; certiorari denied, 273 U. S. 759; *Hazel T. Power*, 23 B.T.A. 428; *affd.*, 61 Fed. (2d) 625; certiorari denied, 288 U. S. 612, and authorities cited.

Judgment will be entered for the respondent.

26 United States Board of Tax Appeals, Washington.

Docket No. 52329.

JAMES McDONALD, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Order Modifying Opinion.

Upon consideration of the motion of petitioner filed herein, that the judgment entered on August 25, 1933, be withdrawn and an order entered that the amount of deficiency be settled under Rule 50, it is hereby

Ordered that the opinion of the Board, promulgated August 22, 1933, be modified by striking out "Judgment will be entered for the respondent," and substituting therefor "Judgment will be entered under Rule 50."

Enter: Entered Sep. 13, 1933.

[Seal U. S. Board of Tax Appeals.]

(Signed)

LOGAN MORRIS,
Member.

27 United States Board of Tax Appeals, Washington.

Docket No. 52329.

JAMES McDONALD, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Judgment.

Subsequent to the Board's report, 28 B.T.A. 1233, the respondent filed a proposed judgment which the petitioner agrees is in conformity with the said report. In accordance therewith, it is

Ordered, adjudged and decided that there is a deficiency of \$5,152.07 in income tax for 1927.

Enter: Entered Nov. 13, 1933.

[Seal U. S. Board of Tax Appeals.]

(Signed) JOHN M. STERNHAGEN,
Member.

28 [Stamp:] United States Board of Tax Appeals.
Filed Feb. 6, 1934.

United States Board of Tax Appeals.

Docket No. 52329.

JAMES McDONALD, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Stipulation.

It is stipulated and agreed that the decision of the Board of Tax Appeals in the above entitled case may be reviewed by the Court of Appeals of the District of Columbia. This agreement is made under and pursuant to the provisions of Section 1002 (d) of the Revenue Act of 1926.

H. C. KILPATRICK,
Attorney for Petitioner.
SEWALL KEY,
Attorney for Respondent.

29 [Stamp:] United States Board of Tax Appeals.
Filed Feb. 12, 1934.

In the United States Board of Tax Appeals.

Docket No. 52329.

JAMES McDONALD, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Petition for Review.

To the Honorable Judges of the Court of Appeals of the
District of Columbia:

Now comes James McDonald, the above named petitioner, by his attorneys, Oscar W. Underwood, Jr., and H. C. Kilpatrick, and, filing this his petition for a review by the Court of Appeals of the District of Columbia of the decision of the United States Board of Tax Appeals rendered and entered the 13th day of November, 1933, determining a deficiency in federal income taxes against petitioner for the year 1927, respectfully shows:

I. Petitioner is an individual, residing at Hailey, Idaho. This petition for review by the Court of Appeals of the District of Columbia is filed pursuant to a stipulation of
30 the parties filed with the Board of Tax Appeals on February 6, 1934, in accordance with the provisions of Section 1002 (d) of the Revenue Act of 1926 (44 Stat. L., P. 2, 9, C. 27).

II. The nature of the controversy is as follows:

The only question is whether or not the Commissioner of Internal Revenue erred in including in petitioner's taxable income for the year 1927 the amount of \$25,000 paid to petitioner's former wife, Beulah Martin, by the trustees of the estate of petitioner's father under the circumstances hereinafter set forth.

Petitioner and Beulah B. McDonald were married on April 17, 1912. They have two sons, born on September 10, 1913 and May 12, 1915, respectively, both of whom are living.

Petitioner's father died in 1915, a resident of the District of Columbia, leaving a will and codicil whereunder he provided that his estate was to be held by the executors and trustees named therein, and certain annuities were to be paid until petitioner's oldest surviving child should reach the age of thirty years, at which time petitioner was to receive one-half of the corpus of the estate and the other half was to be distributed to and divided among petitioner's children.

In 1922, petitioner brought suit in the Supreme Court of the District of Columbia to have the will declared
31 void on the ground that it violated the rule against perpetuities, and upon dismissal of his suit in that court, he appealed to the Court of Appeals. During the pendency of that appeal, the petitioner on December 11, 1934, entered into a written contract with his wife, Beulah B. McDonald, for the purpose of "fixing, settling and determining their respective property rights." This contract recited the general terms of the will of petitioner's father and the filing of the suit to set aside the will made detailed provision for the children in case petitioner should be held to be the sole heir of his father, and by paragraph 7 thereof, provided as follows:

"7. The party of the first part shall and will, in addition to the payments hereinbefore specified, pay to the party of the second part the sum of Four Hundred Thousand Dollars (\$400,000) in lawful money of the United States, in full settlement of all claims and demands of every kind or character now existing or which but for this agreement might hereafter arise. The said payment of Four Hundred Thousand Dollars (\$400,000) by the party of the first part shall be made to the party of the second part when the party of the first part becomes entitled to his share of the estate of James McDonald, Sr., whether he shall become so entitled thereto pursuant to the provisions of said last will and testament of James McDonald, Sr., deceased, or as his heir at law, or prior thereto if the said party of the first part so elects. For the purpose of further assuring the payment of said Four Hundred Thousand Dollars (400,000) to the party of the second part the said party of the first part does hereby assign, transfer and set over to the said party of the second part an interest in his share of the property of the

32 estate of James McDonald, Sr., in the amount of Four Hundred Thousand Dollars (\$400,000) and directs the trustees named in the will of James McDonald, Sr., or their successors, to pay and deliver to the party of the second part, whenever such payment may be by such trustees lawfully made, the said sum of Four Hundred Thousand Dollars (\$400,000), and in the event that the trust provisions of said will shall hereafter finally be declared void or the said party of the first part shall for any other reason succeed to the estate of James McDonald, Sr., then the executor of said last will and testament and the court in which the administration of said estate is then pending are, and such executor and such court is, hereby authorized, empowered and directed to cause to be distributed and paid to the said party of the second part the said sum of Four Hundred Thousand Dollars (\$400,000).''

After December 11, 1924, and prior to December 21, 1925, petitioner and his wife were divorced, and she resumed her maiden name of Beulah Martin. On December 21, 1925, petitioner and his former wife entered into a supplementary agreement, based upon the condition that the will should be construed as naming petitioner and his two sons as sole legatees of his father and that petitioner should be given one-half of the accumulated and future income of this estate (a possibility not contemplated under the terms of the agreement of December 11, 1924), and on February 2, 1926, a third agreement, further modifying the first agreement, was signed. After making provision for the payment of costs and attorneys' fees in connection with that suit, these modifications substituted for paragraph 7 of the original agreement the following:

33 "And out of the accumulated income payable to James McDonald there will be paid to Beulah Martin the sum of One Hundred Thousand (\$100,000.00) Dollars, which shall be applied as a credit on a contract entered into by and between the parties hereto on the 11th day of December, 1924, under the terms of which said Beulah Martin is to be paid Four Hundred Thousand (\$400,000.00) Dollars. After the application of the above payment of One Hundred Thousand (\$100,000.00) Dollars as a credit on said contract, then said Beulah Martin agrees to accept the sum of Twenty-five Thousand (\$25,000.00) Dollars per year,

without interest, on said contract, until the said total sum of Four Hundred Thousand (\$400,000.00) Dollars shall have been fully paid, and an order shall be given to the Fulton Trust Company of New York to make to Beulah Martin the said payments of Twenty-five Thousand (\$25,000.00) Dollars per year direct to her until the balance of said sum of Four Hundred Thousand (\$400,000.00) Dollars shall have been fully paid. Said payments of Twenty-five Thousand (\$25,000.00) Dollars per year shall be made to Beulah Martin for and during the period of twelve years, unless within that period the one-half of the property of said estate should be delivered to said James McDonald, Jr., and in that event the Fulton Trust Company shall at such date pay to Beulah Martin such sum as will complete the total of Four Hundred Thousand (\$400,000.00) Dollars."

On May 3, 1926, the Court of Appeals entered a decree in the aforesaid appeal (McDonald v. Maxwell, 12 Fed. (2d) 822) as follows:

"(1) That upon the death of the testator, James McDonald, the appellant, James McDonald, Jr., took a present vested interest in the undivided one-half of the testator's estate after the payment of debts, specific legacies, annuities, and costs of administration, the corpus thereof to be paid to said James by the executors under the will when his oldest child living at the testator's death shall reach the age of 30 years.

34 "(2) That pending the payment to said James of the principal of his one-half interest in said estate he is entitled to receive, and the said executors and trustees shall pay to him, in addition to the annuity provided for him by the codicil of said will, the cash income upon the said one-half interest accrued thereon to this date and the future cash income thereon from time to time as the same shall accrue hereafter.

"(3) That upon the death of the testator, James McDonald, the infant defendants and appellees, James McDonald, 3d, and Robert Alexander McDonald, took a present vested interest in the remaining one-half of the estate of said testator after the payment of debts, specific legacies, annuities, and costs of administration, the same to be divided between them, share and share alike, such division

and distribution to be made when the oldest of said children shall reach the age of 30 years, and otherwise provided by the terms of the will."

Pursuant to this decree, there was paid to petitioner in 1926 by the testamentary trustees the accumulated income upon one-half of the estate property, out of which petitioner paid to Beulah Martin the \$100,000 in cash covered by the above quoted provision of the supplemental agreement of February 2, 1926. Pursuant to the same provision, the trustees paid out of the trust income for the year 1927 to Beulah Martin the sum of Twenty-five Thousand Dollars (\$25,000). In their fiduciary return of income for 1927, the trustees reported one-half of the income (including the amount of \$25,000 so paid to Beulah Martin) as income distributable to petitioner.

35 Petitioner, in his federal income tax return for 1927, reported as gross income the full amount reported by the trustees as distributable to him, but deducted therefrom, in computing his taxable net income, the said sum of Twenty-five Thousand Dollars (\$25,000). This deduction the respondent disallowed and, after making other adjustments of petitioner's reported income, determined a deficiency in income tax against petitioner for the year 1927 in the amount of \$12,681.70, and on December 1, 1930, sent petitioner notice of said deficiency, pursuant to the provisions of section 274 of the Revenue Act of 1926. Thereafter, on January 29, 1931, petitioner filed an appeal from said notice of deficiency with the United States Board of Tax Appeals.

The case was submitted to the Board of Tax Appeals for its decision upon an agreed statement of facts, whereunder respondent conceded two of the issues raised by petitioner and petitioner abandoned a third issue, leaving in controversy only the question of the propriety of respondent's action in treating as taxable income of petitioner the said sum of Twenty-five Thousand Dollars (\$25,000) paid to Beulah Martin by the trustees in 1927. On August 22, 1933, the Board promulgated its findings of fact and opinion, determining this issue in favor of the respondent, and on

36 November 13, 1933, the Board entered its decision whereby it ordered and decided that there is a deficiency of \$5,152.07 in income tax for the year 1927.

III. The petitioner's assignments of error are as follows, to-wit:

1. The Board erred in holding that, under the said contract of December 11, 1924, as modified December 21, 1925, and February 2, 1926, "the petitioner merely promised to make payments to his wife out of distributions to be received by him from the estate."

2. The Board erred in holding that, under said contracts, petitioner did not make a valid transfer or assignment of his right to income.

3. The Board erred in holding that said contracts did not divest petitioner of a property interest and the income therefrom.

4. The Board erred in holding that, under said contracts, petitioner had not made an irrevocable assignment to Beulah Martin of an undivided interest in an equitable estate for years.

5. The Board erred in holding that the amount of the income of the trust estate for the year 1927 so paid to Beulah Martin was income of petitioner within the
37 meaning of Sections 210 and 211 of the Revenue Act of 1926.

6. The Board erred in determining that there is a deficiency in petitioner's income tax for the year 1927.

Wherefore, the petitioner prays that the decision of the Board of Tax Appeals be reviewed by the Court of Appeals of the District of Columbia; that a transcript of the record be prepared in accordance with the law and with the rules of said Court and transmitted to the Clerk of said Court for filing; and that appropriate action be taken to the end that the errors complained of may be reviewed and corrected by said Court.

OSCAR W. UNDERWOOD, JR.,

H. C. KILPATRICK,

Attorneys for Petitioner.

DISTRICT OF COLUMBIA, ss:

H. C. Kilpatrick, being duly sworn, says that he is attorney for James McDonald, the above named petitioner, and as such is duly authorized to verify the foregoing petition for review; that he has read said petition and is familiar with the contents thereof; and that said petition

is true, to the best of his knowledge, information and belief.
H. C. KILPATRICK.

Subscribed and sworn to before me this 12th day of February, 1934.

[Seal of Gertrude Ellis, Notary Public, District
of Columbia.]

GERTRUDE ELLIS,

Notary Public, D. C.

My commission expires August 3, 1936.

38 [Stamp:] United States Board of Tax Appeals.
Filed Feb. 12, 1934.

In The United States Board of Tax Appeals.

Docket No. 52329.

JAMES McDONALD, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Notice of Filing Petition for Review.

To The General Counsel,
Bureau of Internal Revenue,
Attorney for Respondent.

Please take notice that we have, on February 12, 1934, lodged with the Clerk of the United States Board of Tax Appeals, at Washington, D. C., on behalf of the above named petitioner, a petition for review by the Court of Appeals of the District of Columbia of the decision of the Board heretofore rendered in the above entitled case, a copy of which petition is hereto attached and served upon you.

OSCAR W. UNDERWOOD, JR.,

H. C. KILPATRICK,

Attorneys for Petitioner.

39 Receipt of the above and foregoing notice, together with a copy of the petition mentioned therein, is hereby acknowledged this 12th day of February, 1934.

E. BARRETT PRETTYMAN,
General Counsel,
Bureau of Internal Revenue,
Attorney for Respondent.

40 [Stamp:] United States Board of Tax Appeals.
Filed Apr. 9, 1934.

United States Board of Tax Appeals.

Docket No. 52329.

JAMES McDONALD, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Statement of Evidence.

Be it remembered that this cause came on for hearing before the Honorable John M. Sternhagen, Member of the United States Board of Tax Appeals, on the 3rd day of November, 1932, at Washington, D. C. Oscar W. Underwood, Jr., Esq., and H. C. Kilpatrick, Esq., of Washington, D. C., appeared for the petitioner, and Maxwell M. Mahany, Esq., appeared for the respondent.

And thereupon, to maintain the issues on his behalf to be maintained, the petitioner offered and the Member received in evidence the following agreed statement of facts, together with the exhibits thereto as hereinafter set forth:

The petitioner and the respondent, through their respective attorneys, do hereby agree and stipulate that the following facts are true, and for all purposes of this proceeding shall be deemed to be proved in the same manner as if proved by competent testimony:

1. The petitioner is an individual residing at Hailey, Idaho.

2. His father, James McDonald, died January 13, 1915, a resident of the District of Columbia, leaving a will
41 executed on June 26, 1913, in London, England, and
a codicil thereto executed on April 13, 1914 in New
York City.

3. By the terms of the will and codicil, the estate was to be held by Lawrence Maxwell and Fulton Trust Company, named as executors and trustees, and certain annuities were to be paid until petitioner's oldest surviving child should reach the age of thirty years, at which time petitioner was to receive one-half of the estate. The petitioner has two children, still surviving, born September 10, 1913, and May 12, 1915, respectively.

4. The will and codicil were admitted to probate in the Supreme Court of the District of Columbia on January 20, 1915, the executors named therein being appointed by the court.

5. On May 6, 1922, petitioner brought suit in the Supreme Court of the District of Columbia to have the will declared void as being in violation of the rule against perpetuities, and, upon dismissal in that court, it was appealed to the Court of Appeals. On May 3, 1926 the Court of Appeals entered a decree in the case (*McDonald v. Maxwell, et al.*, 12 *Fed. (2d)* 822), as follows:

“(1) That upon the death of the testator, James McDonald, the appellant, James McDonald, Jr., took a present vested interest in the undivided one-half of the testator's estate after the payment of debts, specific legacies, annuities, and costs of administration, the corpus thereof to be paid to said James by the executors under the will when his oldest child living at the testator's death shall reach the age of 30 years.

“(2) That pending the payment to said James of the principal of his one-half interest in said estate he is entitled to receive, and the said executors and trustees shall pay to him, in addition to the annuity provided for him by the codicil of said will, the cash income upon the said one-half interest accrued thereon to this date and the future cash income thereon from time to time as the same shall accrue hereafter.

“(3) That upon the death of the testator, James McDonald, the infant defendants and appellees, James McDonald, 3d, and Robert Alexander McDonald, took a present vested interest in the remaining one-half of the estate of said testator after the payment of debts, specific

legacies, annuities, and costs of administration, the same to be divided between them, share and share alike, such division and distribution to be made when the oldest of said children shall reach the age of 30 years, and otherwise provided by the terms of the will."

6. Pursuant to the decision just quoted, there was paid to the petitioner in 1926 by the trustees under the will of James McDonald, Sr., deceased, a sum in excess of \$500,000, representing the "cash income upon the said one-half interest accrued thereon to this date," as provided for in the decision. Out of said \$500,000 the petitioner paid to Beulah Martin the \$100,000 in cash, as provided for in paragraph 2 of the agreement of December 21, 1925, as modified by paragraph 2, of the agreement of February 2, 1926.

7. On December 11, 1924, petitioner entered into a written agreement with his then wife, Beulah B. McDonald, a true and correct copy of which is attached hereto and marked Exhibit A.

8. Thereafter and prior to December 21, 1925, petitioner and the said Beulah B. McDonald were divorced, she resuming her maiden name of Beulah Martin.

9. On December 21, 1925, petitioner entered into a written agreement with said Beulah Martin (formerly Beulah B. McDonald), a true and correct copy of which is attached hereto and marked Exhibit B.

10. On February 2, 1926, petitioner entered into a written agreement with said Beulah Martin, which, after
43 reciting the making of the agreement of December 21, 1925, provided as follows:

"Further negotiations looking to the settlement of the suit now pending on appeal in the Court of Appeals of the District of Columbia involving the validity of the Will of James McDonald, Sr., referred to in such memorandum of agreement, have shown that 'the entire accumulated income' possibly cannot be applied to the payment of costs and other expenses incident to the prosecution of said suit, but that there can possibly be used for said purposes only the one-half of such entire accumulated income that will be awarded to James McDonald, Jr., as a result it may become necessary to modify and amend paragraphs 1 and 2 of such memorandum of agreement. Accordingly, and

in such event, paragraph 1 of such agreement will be modified and amended to read as follows:

'That such costs as may be adjudged against James McDonald in the Supreme Court of the District of Columbia and in the Court of Appeals of said District shall be first paid out of the one-half of the said accumulated income to be distributed to the said James McDonald; also the expenses incurred by the said James McDonald in the prosecution of said suit; and the attorneys fees incurred by the said James McDonald in the prosecution of the said suit, which shall include Twenty Thousand (\$20,000) Dollars to be paid to U. S. Webb, as attorney for Beulah McDonald (now Beulah Martin) the balance of said fee of said Webb to be paid by the said Beulah Martin.'

"Paragraph 2 of said memorandum of agreement so signed and executed as aforesaid is hereby modified and amended to read as follows:

'And out of the accumulated income payable to James McDonald there will be paid to Beulah Martin the sum of One Hundred Thousand (\$100,000.00) Dollars, which shall be applied as a credit on a contract entered into by and between the parties hereto on the 11th day of December, 1924, under the terms of which said Beulah Martin is to be paid Four Hundred Thousand (\$400,000.00) Dollars.

44 After the application of the above payment of One Hundred Thousand (\$100,000.00) Dollars as a credit on said contract, then said Beulah Martin agrees to accept the sum of Twenty-five Thousand (\$25,000.00) Dollars per year, without interest, on said contract, until the said total sum of Four Hundred Thousand (\$400,000) Dollars shall have been fully paid, and an order shall be given to the Fulton Trust Company of New York to make to Beulah Martin the said payments of Twenty-five Thousand (\$25,000.00) Dollars per year direct to her until the balance of said sum of Four Hundred Thousand (\$400,000.00) Dollars shall have been fully paid.

'Said payments of Twenty-five Thousand (\$25,000) Dollars per year shall be made to Beulah Martin for and during the period of twelve years, unless within that period the one-half of the property of said estate should be delivered to said James McDonald, Jr., and in that event the Fulton Trust Company shall at such date pay to Beulah

Martin such sum as will complete the total of Four Hundred Thousand (\$400,000.00) Dollars.'

"Paragraphs 1 and 2 as herein amended and modified shall be construed as substituted for paragraphs 1 and 2 as contained in the original memorandum of agreement, and in all other respects said original memorandum of agreement is reapproved and reaffirmed. Executed in duplicate."

11. The Fulton Trust Company and Joseph S. Graydon, as Trustees under the will of James McDonald, deceased, for the year 1927 filed a form 1041 Fiduciary Return, in which the following was reported:

Profit from sale of stocks and bonds	6,856.12	
Interest & miscellaneous income...	23,544.98	
Dividends	181,104.60	
		211,505.70
Deductions: Taxes, Trustees Com-		
missions	31,914.23	31,914.23
Net income.....		179,591.47

The return indicated the following distribution:

"James McDonald, Hailey, Idaho"	90,552.30	(4,184.62)
"Fulton Trust Co. of New York, Trustee for James McDonald 3d and Robert Alex McDonald, 149 Broadway, New York City.....	90,552.30	(4,184.63)
"Fulton Trust Co. of New York and Joseph S. Graydon, Trustees (Profits from sale).....		6,856.12

The trustees filed a Form 1040 return upon which they reported the \$6,856.12 profit from sale of corpus, and paid a tax thereon. They also filed another form 1040 under the style "Fulton Trust Company of New York, Trustee for James McDonald 3rd and Robert Alexander McDonald", in which they reported and paid tax on the \$90,552.30 dividends, less the \$4,184.63 one-half of the loss, accruing to James McDonald, 3rd and Robert Alexander McDonald. The trustees filed no Form 1040 return on behalf of the petitioner, nor did they pay any tax on the \$90,552.30 divi-

dends less \$4,184.63 half of the loss accruing on the half of the current income distributable to the petitioner.

The petitioner, in filing his income tax return for the year 1927 reported as dividends the sum of \$90,552.30 and deducted the \$4,184.63 loss. Among "Other deductions" the petitioner deducted the following:

"Division of Income, former wife Beulah Martin \$25,000"

representing that sum which the trustees, pursuant to the provisions of paragraph 2 of the December 21, 1925 and February 2, 1926 agreements, above set forth, paid out of the \$90,552.30 to Beulah Martin in that year. The respondent, in arriving at the petitioner's taxable net income for the year 1927 as reflected in the Notice of Deficiency, disallowed the \$25,000 deduction theretofore taken by the petitioner on his return.

46 12. The respondent, in arriving at the deficiency for the year 1927 herein involved, included "Additional income from trustees. . \$25,000", representing one-half of a commission repaid by the trustees to the estate of James McDonald, deceased, in that year. The \$25,000 item was not included by the petitioner in his return. The respondent confesses error with respect to this adjustment and agrees that the \$25,000 item, which in no way should be confused with the \$25,000 Beulah Martin item above discussed, should not be included in arriving at petitioner's 1927 net income.

13. The petitioner, in arriving at his net income shown on his return deducted the sum of \$11,000, paid by the trustees in the year 1927 to one of petitioner's former wives, Thaona Aveline McDonald. The respondent, in arriving at the 1927 deficiency, disallowed this sum as a deduction, but now concedes that it was properly deducted by petitioner on his return, and may be deducted in arriving at the deficiency to be redetermined by the Board.

14. The petitioner, in arriving at his net income shown on his return, deducted the sum of \$10,000 as "Attorney fee paid to W. F. Norman for services rendered Thaona Aveline (McDonald)". The respondent, in arriving at the deficiency for 1927, disallowed this sum as a deduction. The petitioner now concedes that the amount was not properly deductible, and agrees that it should be excluded as a deduction in arriving at the 1927 deficiency to be redetermined by the Board.

47

EXHIBIT "A" TO STIPULATION.

Agreement.

This agreement made and entered into this 11th day of December, 1924, by and between James McDonald of Hailey, Idaho, hereinafter called the party of the first part, and Beulah B. McDonald, his wife, the party of the second part,

Witnesseth: That whereas, the said parties intermarried on the 17th day of April, 1912, and have since been and now are husband and wife, and the issue of said marriage is two sons, namely James McDonald, Jr. aged eleven years and two months, and Robert Alexander McDonald, aged nine years and sixth months;

And whereas for a considerable period of time last past the said parties have had under consideration the advisability of entering into an agreement through and by which their respective property rights would be fixed, settled and determined, and the said parties having had under consideration the terms and conditions of such agreement, and the party of the first part having been advised in reference thereto by his attorney, Proctor K. Perkins of Hailey, Idaho, and the party of the second part having been fully advised in relation thereto by her attorney, U. S. Webb of San Francisco, California, and the said parties being so fully advised and informed as to the respective rights, duties and obligations have entered into this agreement for the purpose, in so far as the same may be legally accomplished, of fixing, settling and determining their respective property rights;

And whereas James McDonald, Sr., was the father of the party of the first part and died in Washington, D. C., leaving a last will and testament, which in due course was admitted to probate in the Supreme Court of the District of Columbia, Probate Division, on the 20th day of January, 1915, and the administration of said estate in said court is still pending;

And whereas by said last will and testament of James McDonald, Sr., there was bequeathed to the party of the first part in trust a large amount of property consisting of one-half of the entire estate of said deceased that will remain after the payment of certain bequests and the ex-

penses of administration and that by the terms of said will the said property so left to the party of the first part is to be distributed to him when his oldest surviving child shall reach the age of thirty years, and by the provisions of which last will and testament the other one-half of said property, after the payment of said special bequests and said expenses of administration, shall be distributed
48 to and divided among the children of the party of the first part, share and share alike;

And whereas there was heretofore instituted by the party of the first part and is now being prosecuted by him in the Supreme Court of the District of Columbia suit praying for the construction of the terms of said will and in which the party of the first part has contended and is contending that certain of the provisions of said will are void, and if such contention be by the Court finally sustained the said party of the first part will succeed to the entire estate of said James McDonald, Sr., after the deduction of said special bequests and said expenses of administration, and in that event the said party of the first part will inherit the said estate as the sole heir at law of his father, the said James McDonald, Sr., deceased.

Now therefore, in consideration of the mutual covenants from each to the other running and of good and valuable consideration not herein expressed from each to the other moving, the parties hereto have agreed and do hereby agree as follows, to-wit:

1. That said agreement, executed in triplicate by the parties hereto, shall be and is a full, complete and final settlement, adjustment and determination of their and each of their property rights, and each of the parties hereto does by these presents release and discharge the other from any and all claims and demands whatsoever, except such as hereafter exist under and in pursuance of this agreement.

2. That the separate property of each of the parties hereto shall from and after the execution of this agreement and the same is vested absolutely in the respective parties, free and clear of any and all obligations or liabilities by reason of the marriage relation now and heretofore existing between the said parties or otherwise, and each of said parties does hereby waive and relinquish all and every claim to the property of the other except as the same is provided for herein.

3. That each of the parties agrees to hereafter make, execute and deliver on demand any and all conveyances or otherwise which may become necessary in order to carry into full force and effect the terms and conditions of this agreement.

4. The party of the first part shall and will in the event that the suit now pending in the Supreme Court of the District of Columbia hereinbefore referred to be so finally decided that the party of the first part succeeds to the estate of James McDonald, Sr. as his heir at law, or if by compromise, settlement or otherwise the said party of the first part shall so succeed to said estate as such heir at law, then the party of the first part shall and will assign, set over and transfer for the use of the two sons of the parties

49 hereto an undivided one-half interest in and to all of the property and estate which the party of the first part shall so inherit, and for the accomplishment of such purpose the said party of the first part does hereby assign, transfer and set over for the benefit of said two children, James McDonald, Jr. and Robert Alexander McDonald, one-half of all of said estate and property to the Fulton Trust Company of New York, or to such other trustee as the parties may hereafter mutually agree upon, in trust for the use and benefit of the said James McDonald, Jr. and Robert Alexander McDonald to be by such trustee delivered to them respectively as and when they each become twenty-one years of age. It is further provided and declared as and constituting a part and provision of this trust that the net income from such estate shall be by said trustee paid to said James McDonald, Jr. and said Robert Alexander McDonald monthly until they reach the age of twenty-one years; provided, however, that the aggregate payment from such income to each of said children shall not exceed Twelve Thousand Dollars (\$12,000) per year, and in the event that there remains after the payment of Twelve Thousand Dollars (\$12,000) per year to each of said children from said net income any excess, such excess shall be the separate property of the party of the first part and shall be by said trustee annually paid over to him. The estate in this paragraph mentioned is and shall be understood to be the net estate to be distributed after the payment of any and all annuities, settlements, charges and expenses of litigation and administration.

5. The said party of the first part shall and will if a child or children shall hereafter be born to him who would be entitled to share in the estate of the aforementioned James McDonald, Sr., deceased, as provided in his last will and testament, in addition to the provision heretofore made, give, assign and transfer to James McDonald, Jr. and Robert Alexander McDonald from his own separate estate sums equal to the amounts that their inheritances shall have been decreased by reason of the birth to the party of the first part hereafter of such child or children.

6. There having become due annually to the party of the first part pursuant to the terms of the will of his father, James McDonad, Sr. a sum of money in excess of Twelve Thousand Dollars (\$12,000) as an annuity, and the party of the first part having heretofore, to-wit, on August 19, 1921, assigned to the party of the second part from said annuity the sum of One Thousand Dollars (\$1,000) per month, payable monthly, therefrom and said assignment having been filed with the Fulton Trust Company and subsequent thereto said One Thousand Dollars (\$1,000) having been so paid monthly to the party of the second part, the said party of the first part does hereby confirm the said assignment and further directs the said Fulton Trust Company to continue the payment to said party of the second part of the said One Thousand Dollars (\$1,000) monthly for her sole use and benefit and as her separate property. And

50 the said party of the first part does hereby, in addition to the foregoing, assign and transfer irrevocably to the party of the second part such increases of allowance or annuity as by the terms of said will shall hereafter become due to the said two children and the payments of the amounts so assigned shall continue until the trust created by said will shall be terminated.

7. The party of the first part shall and will, in addition to the payments hereinbefore specified, pay to the party of the second part the sum of Four Hundred Thousand Dollars (\$400,000) in lawful money of the United States, in full settlement of all claims and demands of every kind or character now existing or which but for this agreement might hereafter arise. The said payment of Four Hundred Thousand Dollars (\$400,000) by the party of the first part shall

be made to the party of the second part when the party of the first part becomes entitled to his share of the estate of James McDonald, Sr., whether he shall become so entitled thereto pursuant to the provisions of said last will and testament of James McDonald, Sr., deceased, or as his heir at law, or prior thereto if the said party of the first part so elects. For the purpose of further assuring the payment of said Four Hundred Thousand Dollars (\$400,000) to the party of the second part said party of the first part does hereby assign, transfer and set over to the said party of the second part an interest in his share of the property of the estate of James McDonald, Sr. in the amount of Four Hundred Thousand Dollars (\$400,000) and directs the trustees named in the will of James McDonald, Sr., or their successors, to pay and deliver to the party of the second part, whenever such payment may be by such trustees lawfully made, the said sum of four Hundred Thousand Dollars (\$400,000), and in the event that the trust provisions of said will shall hereafter finally be declared void or the said party of the first part shall for any other reason succeed to the estate of James McDonald, Sr., then the executor of said last will and testament and the court in which the administration of said estate is then pending are, and such executor and such court is hereby authorized, empowered and directed to cause to be distributed and paid to the said party of the second part the said sum of Four Hundred Thousand Dollars (\$400,000).

This agreement shall be by the respective parties executed and acknowledged in triplicate, each of the parties hereto shall have and hold one copy thereof and the third copy shall be filed with the Fulton Trust Company of New York.

In witness whereof the parties hereto have hereunto set their hands on the day and year herein first above
51 written.

JAMES McDONALD,
Party of the First Part.

Witness:
PROCTOR K. PERKINS.

BEULAH B. McDONALD,
Party of the Second Part.
Witness:
U. S. WEBB.

STATE OF IDAHO,
County of Blaine, ss:

On this 15th day of December, 1924, before me Proctor K. Perkins, a notary public for the State of Idaho personally appeared James McDonald and Beulah B. McDonald known to me to be the persons who are described in, and who executed the within instrument, and acknowledged to me that they executed the same freely and voluntarily, and for the uses and purposes therein set forth.

Given under my hand and notarial seal the day and year last above written.

PROCTOR K. PERKINS,
Notary Public for Idaho,
Residing at Hailey, Idaho.

52 EXHIBIT "B" TO STIPULATION.

Memorandum of Agreement Between James McDonald and
Beulah Martin (Formerly Beulah McDonald).

It is agreed by and between the parties hereto as follows:

In the event that the suit now pending on appeal in the Court of Appeals in the District of Columbia involving the validity of the will of James McDonald, Sr., the court should so construe the will as to hold that the testator intended only to include as his legatees his son James McDonald and his two grandchildren living at the time of the testator's death, namely—James McDonald, Jr., and Robert Alexander McDonald; and should further hold that all of the contingent legatees named in paragraphs M, N, O and P of said will, except the same James McDonald and the said two children above named, take no interest whatever under said will, and provide further that an arrangement is made whereby one-half of the accumulated income now in the hands of the executors and trustees may be paid over to the said James McDonald, and the further payment of one-half of said income as it accumulates may be paid to the said James McDonald, then in such event it is agreed by and between the parties hereto as follows:

1. That all the costs and other expenses incident to the prosecution of said suit in the Supreme Court of the District of Columbia and in the Court of Appeals of said District, including counsel fees of plaintiff, the defendant,

Beulah McDonald and guardian ad litem for said minor defendants be first paid out of the entire accumulated income.

2. And out of the accumulated income payable to James McDonald there will be paid to Beulah Martin the sum of One Hundred Fifty Thousand (\$150,000) Dollars, One Hundred Thousand (\$100,000.00) Dollars of which is to be applied as a credit on a contract entered into by and between the parties hereto on the 11th day of December 1924, under the terms of which said Beulah Martin is to be paid Four Hundred Thousand (\$400,000.00) Dollars. The other Fifty Thousand (\$50,000.00) Dollars to be in full payment for household furniture, paintings, works of art, etc., heretofore given to the said Beulah Martin by the said James McDonald, said property to be returned to the said James McDonald in the event he cares to exercise the option to re-purchase the same (this not to include family jewels). In the event said James McDonald does not care to exercise the option to pay Fifty Thousand (\$50,000.00)

53 Dollars for said property, then the said Beulah Martin is to receive the sum of One Hundred Fifty Thousand (\$150,000.00) Dollars to be applied as a credit on the Four Hundred Thousand (\$400,000.00) provided in said contract of December 11, 1924. After the application of the above payment as a credit on said contract, then said Beulah Martin agrees to accept the sum of Twenty-five Thousand (\$25,000.00) Dollars per year direct to the said Beulah Martin until the balance of said Four Hundred Thousand (\$400,000.00) Dollars is liquidated.

3. It is further agreed in the event said decree is entered that said contract of December 11th, 1924, will be novated and reformed by the elimination of all of paragraphs 5, 6 and 7, and the copy of said contract now on file with the Fulton Trust Company of New York will be withdrawn and another contract executed and filed in its stead in accordance with the stipulation herein.

4. The Four Hundred Thousand (\$400,000.00) Dollar settlement provided in paragraph 7 of said contract of December 11th, 1924, includes a note of Two Hundred Thousand (\$200,000.00) Dollars heretofore executed by the said James McDonald and payable to Beulah Martin, and note having been executed so that the annual interest thereon would guarantee the payment of the One Thousand (\$1,000.00) Dollars per month referred to in paragraph 6 of

said contract. Upon the execution of said settlement as herein outlined, said One Thousand (\$1,000.00) Dollars per month will cease and said note of Two Hundred Thousand (\$200,000.00) Dollars will be surrendered by said Beulah Martin to James McDonald.

Executed in triplicate at Tucson, Arizona, this the 21st day of December, 1925.

BEULAH L. MARTIN.
JAMES McDONALD.

The foregoing statement contains all of the evidence offered in this cause.

OSCAR W. UNDERWOOD, JR.,
H. C. KILPATRICK,
Attorneys for Petitioner.

Approved:

ROBERT H. JACKSON,
*General Counsel, Bureau of Internal Revenue,
Attorney for Respondent.*

Approved and ordered filed:

(S.) J. M. STERNHAGEN,
Member United States Board of Tax Appeals.

4/9/34.

54 [Stamp:] United States Board of Tax Appeals.
Filed Apr. 6, 1934.

United States Board of Tax Appeals.

Docket No. 52329.

JAMES McDONALD, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Præcipe.

To the Clerk of the United States Board of Tax Appeals:

You will please prepare, transmit and deliver to the Clerk of the Court of Appeals of the District of Columbia, within the time allowed by the rules of that Court in this

respect, a transcript of record for review herein consisting of the following:

1. The docket entries of the proceedings before the Board.

2. Pleadings before the Board:

55 (a) Petition, including annexed copy of deficiency letter.

(b) Answer.

(c) Motion filed April 24, 1933, for leave to file amended petition, and order entered thereon April 26, 1933.

3. Opinion and decision of the Board.

4. Petition for review and notice of filing.

5. The statement of evidence as agreed upon by counsel and approved by the Board of Tax Appeals.

6. Stipulation of counsel filed March 22, 1934.

7. This præcipe.

OSCAR W. UNDERWOOD, JR.,

H. C. KILPATRICK,

Attorneys for Petitioner.

Service of a copy of the foregoing præcipe is hereby admitted this 6th day of April, 1934.

ROBERT H. JACKSON,

General Counsel,

Bureau of Internal Revenue,

Attorney for Respondent.

56 United States Board of Tax Appeals, Washington.

Docket No. 52329.

JAMES McDONALD, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Certificate.

I, B. D. Gamble, clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages, 1 to 55, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Præcipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this 8th day of May, 1934.

[Seal U. S. Board of Tax Appeals.]

B. D. GAMBLE,
Clerk United States Board of Tax Appeals.

57 United States Board of Tax Appeals.

Docket No. 52329.

JAMES McDONALD, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent.

Order Enlarging Time.

For cause appearing of record, it is

Ordered: That the time for transmission and delivery of the record *sur* petition for review of the above entitled proceeding in the Court of Appeals of the District of Columbia, be and it is hereby extended to May 30, 1934.

[Seal U. S. Board of Tax Appeals.]

(Signed)

EUGENE BLACK,
Member.

Dated Washington, D. C., April 13, 1934.

Now, May 8, 1934, the foregoing is certified from the record as a true copy.

B. D. GAMBLE,
Clerk U. S. Board of Tax Appeals.

Endorsed on cover: Board of Tax Appeals. No. 6227. James McDonald, petitioner, vs. Guy T. Helvering, Commissioner of Internal Revenue. Court of Appeals, District of Columbia. Filed May 17, 1934. Henry W. Hodges, Clerk.

UNITED STATES
COURT OF APPEALS FOR THE
DISTRICT OF COLUMBIA

FILED AUG 20 1934

Henry W. Hodges

CLERK

IN THE
Court of Appeals, District of Columbia

APRIL TERM, 1934.

No. 6227.

JAMES McDONALD, *Petitioner,*

v.

GUY T. HELVERING, Commissioner of Internal Revenue,
Respondent.

On Petition to Review Decision of United States
Board of Tax Appeals.

BRIEF FOR PETITIONER.

OSCAR W. UNDERWOOD, JR.,
H. C. KILPATRICK,
Attorneys for Petitioner.

IN THE
Court of Appeals, District of Columbia

APRIL TERM, 1934.

No. 6227.

JAMES McDONALD, *Petitioner,*

v.

GUY T. HELVERING, Commissioner of Internal Revenue,
Respondent.

On Petition to Review Decision of United States
Board of Tax Appeals.

BRIEF FOR PETITIONER.

INTRODUCTION.

The sole question involved is whether a distribution of \$25,000, made to petitioner's former wife from the income of a trust estate of which petitioner was a bene-

ficiary, pursuant to a written contract between petitioner and his said former wife, should be included in petitioner's taxable income. The Board of Tax Appeals held that it should, its opinion being reported in 28 B. T. A. 1234. The Board's decision was entered November 13, 1933 (R. 24) and petitioner duly filed his petition for review on February 12, 1934 (R. 25).

STATEMENT OF FACTS.

The facts were stipulated below and are substantially as follows:

Petitioner's father died January 13, 1915, a resident of the District of Columbia, leaving a will and codicil which were admitted to probate in the Supreme Court of the District of Columbia. The residuary estate was left to Lawrence Maxwell and The Fulton Trust Company of New York, the executors named in the will, in trust for the benefit of petitioner and his children until the oldest surviving child should reach the age of thirty years, at which time the corpus was to be distributed, one-half to petitioner and the other half to his children. Petitioner has two sons born, respectively, September 10, 1913, and May 12, 1915 (R. 32-33).

Some years after the will was admitted to probate, petitioner brought suit in the District of Columbia to have certain of its provisions declared void as in violation of the rule against perpetuities (R. 33), and praying the Court accordingly to decree that petitioner was entitled as sole heir at law to the possession of the estate (12 Fed. (2d) 822). This bill was dismissed by the trial court and an appeal taken to this court (R. 33).

On December 11, 1924, while that appeal was pending, petitioner and his wife, Beulah Martin, entered into a written contract for the purpose of "fixing, set-

ting and determining their respective property rights." This agreement is set out in full at pages 38-42 of the printed record. Petitioner agreed that, if in his pending suit he should be adjudged the sole heir of his father, he would assign a half interest in the estate to the use of his sons, and other provisions for them, not material here, were included. Under paragraph 7 of that agreement, petitioner agreed to pay his wife \$400,000 when he should become entitled to his share of his father's estate, whether as heir or under the will, petitioner having the right to pay this amount prior to that time, if he should so elect. For the stated purpose "of further assuring the payment" of this amount to his wife, the agreement provided that petitioner "does hereby assign, transfer and set over" to his wife "an interest in his share of the property of the estate" in the amount of \$400,000 "and directs the trustees * * * to pay and deliver" that amount to the wife "whenever such payment may be by such trustees lawfully made," the trustees and the court administering the estate being directed to pay over that amount to her whenever petitioner should succeed to his father's estate. This agreement concluded with a provision that an executed copy of the agreement be filed with the trustees.

Petitioner and Beulah Martin were divorced at some time between December 11, 1924, and December 21, 1925 (R. 34). On the latter date they entered into an agreement modifying the agreement of December 11, 1924 (R. 34, 43).

The 1925 agreement was conditioned upon this court so construing the will as to hold that petitioner and his children were the sole legatees thereunder, and further conditioned upon an arrangement being made whereby

half of the accumulated trust income should be paid to petitioner and whereby he would thereafter receive half of such income as accumulated. The agreement provided that, upon the happening of such conditions, certain costs and expenses of the litigation should be paid from the accumulated income, and that, from the same source, the wife would receive \$100,000 as a credit on the \$400,000 above mentioned, and \$50,000 for the purchase of certain furniture, paintings and works of art by petitioner from his wife, or if he should elect not to purchase the same, this amount also was to be applied as a credit on the \$400,000. The 1925 agreement thereupon stated:

“After the application of the above payment as a credit on said contract, then said Beulah Martin agrees to accept the sum of Twenty-five Thousand (\$25,000.00) Dollars per year direct to the said Beulah Martin until the balance of said Four Hundred Thousand (\$400,000.00) Dollars is liquidated.

“3. It is further agreed in the event said decree is entered that said contract of December 11th, 1924, will be novated and reformed by the elimination of all of paragraphs 5, 6 and 7, and the copy of said contract now on file with the Fulton Trust Company of New York will be withdrawn and another contract executed and filed in its stead in accordance with the stipulation herein.”

On February 2, 1926, petitioner entered into a third contract with his wife, further modifying the agreement embodied in the 1924 and 1925 contracts. This 1926 contract recited that negotiations looking to the settlement of petitioner's suit pending in this court had shown that possibly only one half of the entire accumulated trust income could be applied to the payment

of the costs and expenses mentioned in the 1925 agreement, and that it might become necessary, therefore to modify and amend the same. Paragraphs 1 and 2 of the 1925 agreement were "accordingly, and in such event" amended to provide that the costs and expenses in question should be paid from the petitioner's half of such accumulated income; and that petitioner should pay to Beulah Martin from the same source \$100,000 to be applied on the \$400,000 obligation (the provisions concerning his purchase from her of the "furniture, paintings, etc., being eliminated). This agreement then stated (the petitioner being described therein as James McDonald, Jr., as he then styled himself):

"After the application of the above payment of One Hundred Thousand (\$100,000) Dollars as a credit on said contract, then said Beulah Martin agrees to accept the sum of Twenty-five Thousand (\$25,000) Dollars per year, without interest, on said contract, until the said total sum of Four Hundred Thousand (\$400,000) Dollars shall have been fully paid, and an order shall be given to the Fulton Trust Company of New York to make to Beulah Martin the said payments of Twenty-five Thousand (\$25,000) Dollars per year direct to her until the balance of said sum of Four Hundred Thousand (\$400,000) Dollars shall have been fully paid.

"Said payments of Twenty-five Thousand (\$25,000) Dollars per year shall be made to Beulah Martin for and during the period of twelve years, unless within that period the one-half of the property of said estate should be delivered to said James McDonald, Jr., and in that event the Fulton Trust Company shall at such date pay to Beulah Martin such sum as will complete the total of Four Hundred Thousand (\$400,000) Dollars."

Paragraph 3 of the 1925 agreement was not changed, but was "reapproved and reaffirmed." (R. 36)

On May 13, 1926, this Court decided petitioner's appeal in the will contest action, holding (*McDonald v. Maxwell, et al.*, 12 Fed. (2d) 822, 825):

1. That on his father's death petitioner "took a present vested interest in the undivided one-half of the testator's estate after the payment of debts, specific legacies, annuities, and costs of administration, the corpus thereof to be paid to said James by the executors under the will when his oldest child living at the testator's death shall reach the age of 30 years."

2. That, pending payment of the principal, the executors and trustees must pay to petitioner the accrued cash income on his half interest "and the future cash income thereon from time to time as the same shall accrue hereafter."

3. That petitioner's sons, on the death of petitioner's father, took a present vested interest in the other one-half, to be divided between them when the oldest shall reach the age of 30 years.

Pursuant to this decision, the trustees paid petitioner in 1926 the cash income which had accrued on his half-interest to that date (out of which petitioner paid Beulah Martin the \$100,000 provided in paragraph 2 of the agreement of December 21, 1925, as modified by paragraph 2 of the agreement of February 2, 1926), and in 1927 they paid him all of such current income except \$25,000, which the trustees paid direct to Beulah Martin pursuant to the provisions of the agreements

between petitioner and Beulah Martin, above set forth (R. 34, 37). Petitioner included the \$25,000 in question in gross income in his return, but deducted the same in computing his net income upon which tax was paid (R. 37). The Commissioner of Internal Revenue (the respondent here) denied petitioner the right to take this deduction, added the amount in question to his reported net income, and asserted a deficiency in tax. The Board of Tax Appeals sustained the Commissioner's determination, on the ground that the agreements in question did not have the effect "of divesting the petitioner absolutely and irrevocably of an undivided part of his equitable estate in the income."

QUESTIONS INVOLVED AND ERRORS RELIED UPON.

Since the Board properly held that petitioner's interest in the income of his father's estate was "an equitable estate for years and present property, alienable at common law like any other," the real question is whether the written agreements between petitioner and Beulah Martin amounted to an irrevocable assignment of an interest in that estate, which divested petitioner of a property interest and the right to receive such income. All of the errors assigned (R. 30) are relied upon as being inherent in the Board's determination that the agreements did not have this effect.

ARGUMENT.

I. The Contract Between Petitioner and His Wife, Embodied in the Three Written Agreements, Constituted an Irrevocable Assignment, to the Extent of \$25,000 Per Year, of His Right to Receive Income of the Trust Estate.

(a) The circumstances surrounding the contract.

When the 1924 agreement was made, petitioner was contesting his father's will and contending that he was entitled to immediate possession of the entire estate. With this possibility in view, he agreed that he would pay his wife a lump sum of \$400,000 when he "should become entitled to his share" of his father's estate. As security for this payment, he made a present assignment of his interest in the corpus to that extent, to be paid and delivered to her by the testamentary trustees "whenever such payment may by such trustees lawfully made." That time, of course, would be whenever the trustees were required to deliver the estate to petitioner. It is quite apparent that the parties had in mind only two possible results of the suit; namely, that the will would be set aside and petitioner would inherit the corpus as well as accumulated income, as sole heir at law, or that the will would be sustained and construed as permitting the trustees to continue to accumulate the income. Although a large fund had accumulated in this way on petitioner's half of the estate (amounting to over \$500,000 in 1926), no mention is made of it.

When the 1925 agreement was made, it is apparent that the parties took a different view of the possibilities of the litigation. The entire agreement is conditioned

upon the court so construing the will as to require the distribution of the accumulated income, and the current distribution of future income but denying petitioner's claim to the corpus. Petitioner agreed to pay his wife \$150,000 out of these accumulations. As to the balance of the \$400,000 obligation, she agreed "to accept the sum of * * * \$25,000 per year direct" to her until the balance should be paid. This agreement, subject to the same condition, provided for the elimination of the paragraph in the 1924 agreement which carried the assignment of \$400,000 of the corpus. Since she was to receive \$100,000 (or \$150,000) of the \$400,000 from accumulated income, the assignment would have been modified at least as to amount. However, it is not reasonable to suppose that she would have given up a vested right in the corpus for a mere promise on petitioner's part to pay her \$25,000 per year thereafter. That she did not do so, and that she looked to the trustees for protection, is apparent, not only from the use of the word "*direct*" but because paragraph 3 provided that a copy of the agreement should be executed and filed with the trustees. If she was to rely on petitioner's promise to pay and be relegated to a claim against him, neither of these provisions was necessary or desirable. It is also significant that he did not personally promise to pay her these instalments. That the annual payments were to come out of the income of the trust estate, and not the corpus, is obvious, since the trustees, under the anticipated construction of the will named in this agreement (and under the construction finally put upon the will by this Court), cannot make any payments from corpus, prior to the date on which petitioner's oldest son shall reach the age of thirty, which will be in 1943.

The 1926 agreement makes even clearer the intention that the income payments were to be made to her by the trustees, since it states that "an order shall be given to the Fulton Trust Company of New York to make to Beulah Martin the said payments * * * direct to her * * *." The record shows (R. 37) that the trustees made such payment to her "pursuant to" this agreement.

(b) No particular words or special form is necessary to assign a right of this kind.

In determining whether the parties to such a contract have effected an assignment, the Supreme Court has said that "the important thing is not whether they used the present or the future tense, but the scope of the contract." *Barnes v. Alexander*, 232 U. S. 117, 121, 58 L. ed. 530, 533. In that case, an attorney employed on a contingent basis orally employed other attorneys to assist him, saying: "If you will attend to this case I will give you one third of the fee which I have coming to me on a contingent fee." This was held to constitute an assignment, giving the assignees a lien upon the fund itself.

Similarly, in *Dexter v. Gordon*, 11 App. D. C. 60, there was an oral agreement to pay a certain sum by an interest in a claim against a foreign government. This was held to be a valid assignment of a part of the claim, the court saying (p. 65): "His was not a mere promise to pay her out of the fund whenever he might collect the same, but an offer, a promise, to assign her a present interest in the claim itself. Without regard to the form of words, this was his plain intention, and equity will regard that as done which ought to be done, and give effect to it."

To the same effect is *Sanborn v. Maxwell*, 18 App. D. C. 245, involving an oral agreement to pay an associate attorney a stated sum with the agreement that the sum "was to be, to that extent, an interest in" the fees of the assignor.

"To constitute an equitable assignment of a chose in action, all of the authorities concur in holding that no particular words or special form is necessary. Indeed, it may be by parol, and, as a general rule, *anything written, said, or done, in pursuance of an agreement*, and for valuable consideration, or in consideration of an antecedent debt, *to place a chose in action or fund out of the control of the owner, and appropriate it to or in favor of another person, amounts to an equitable assignment.*" (Italics supplied) *National Bank v. United Security Life Insurance Co.*, 17 App. D. C. 112, 123.

In *Curtis v. Walpole Tire & Rubber Co.* (C. C. A. 1st), 218 Fed. 145, a corporation delivered to A, who held its note for \$15,000, a letter to its debtor, the F Company, reading as follows: "This is to certify that your account, amounting approximately to \$15,000, shall be paid to A in the usual sums which you deposit. Please accept this as an order to pay him direct if he so desires." The Court held that this was not a mere promise to pay the note out of a particular fund, but "was an actual appropriation of the account as it then existed, and a constructive appropriation of it as to sums that might become due in the future." The Court says (p. 148):

"By the assignment an equitable interest in the account as it then stood, and as it might thereafter accrue, passed to the claimant as security for his note, together with a power to collect the

account and apply the proceeds in satisfaction of the note. As the assignment vested in the claimant an equitable interest in the account, with a power to collect the same, he thereby became possessed of a power coupled with an interest in the account assigned, which was irrevocable.”

In *Nelson v. Ferguson* (C. C. A. 3d), 56 F. (2d) 121, the taxpayer was a party to a patent royalty contract, whereunder he was to receive a specified portion of the profits from exploitation of the patent. He entered into a written agreement with his wife saying: “Harry L. Nelson hereby waives his right to receive all profits” under the agreement “in favor of Anna L. Estelle Nelson * * * and he further agrees to authorize” the other party to his royalty contract “in writing to pay all such profits to” his wife. This was held to be a valid assignment, the court saying (p. 125):

“Though inartificially expressed the meaning * * * is certain and operated as a valid assignment * * *; or, if uncertain, the parties have by their conduct through five years made it certain, notably by Nelson’s immediate instruction to the Warner Company to pay all profits to his wife, by payments regularly made to her and the uninterrupted treatment of the profits by both husband and wife as her property.”

In *Eisenlohr v. Erich* (C. C. A. 3d), 296 Fed. 816 (Cert. denied, 265 U. S. 584, the facts were these:

Dier & Company in November and December, 1921, borrowed \$45,000 from Eisenlohr on the oral understanding that he should be given, as security, “the equity” in certain New York property owned by Dier & Company subject to a first mortgage. The Company gave Eisenlohr stock in a mining company to hold un-

til the property could be incorporated and securities issued for the equity and delivered to him. Dier & Company then incorporated the property, but hypothecated the stock with one Starr as collateral for a loan. With bankruptcy impending, Dier & Company told Eisenlohr of this loan, and that upon paying Starr \$4,000 he (Eisenlohr) could obtain the stock. Eisenlohr thereupon on January 14, 1922, gave an agent of Dier & Company a check for that amount to pay Starr. On the same day, a petition in bankruptcy against Dier & Company was filed. On January 15, Starr was paid and gave up the stock to Dier & Company's agent. The same day attorneys for petitioning creditors and the bankrupt appeared before the court and agreed on the appointment of a receiver. On January 15, stock in the realty company was delivered to Eisenlohr, and on the same date a receiver was appointed. The trustee of the bankrupt brought suit against Eisenlohr, praying that the transfer of the stock to Eisenlohr be set aside as a preference.

The court stated the question to be whether the transaction with Eisenlohr in 1921 "was a present pledge of a security to be completed when, in the future, it was made capable of delivery, or was a mere promise to give security in the future", and said (p. 821):

Gathered from the language which the parties used, and construed in the light of the attendant circumstances, we find there was intention on the part of Dier & Company presently to appropriate and assign, and intention on the part of Eisenlohr presently to accept, the equity in the property as the security for the proposed loans. In view of the intangible character of the security and the impossibility of immediate delivery the appropria-

tion was necessarily constructive. Yet it was complete for it was intended to vest in the assignee a present right which, we do not doubt, would have sustained an action by him against the assignor. We regard this a stronger case of an equitable assignment, and therefore of an equitable lien, than some that have been cited in the Pennsylvania reports."

In *Iowa Bridge Company v. Commissioner* (C. C. A. 8th), 39 F. (2d) 777, it appeared that stockholders of a corporation engaged in bridge construction work had adopted a resolution to assign to its president and principal stockholder certain uncompleted contracts. No written contract was made between the corporation and its president, and no notice of the assignment was given either to the surety companies which had bonded the corporation (except verbally to a general agent) or to the several counties with which the contracts had been made, but the accounts were transferred on the books from the corporation to the individual, and he completed the work and reported the resulting profit. The Commissioner attempted to tax the corporation, and was sustained by the Board of Tax Appeals on the ground that "the alleged transfer of contracts resolves itself into a mere attempt to transfer income already earned."

The Circuit Court of Appeals reversed this holding, saying (p. 780):

"The means by which these contracts were sought to be assigned was the adoption by the stockholders of a resolution. This was made a matter of record, and the books of the company otherwise indicate an assignment of the contracts. Carpenter accepted the assignment, acted thereon, performed all of the contracts, and performance

by him was accepted by the counties with which the contracts were made, and settlements were made thereunder. Before the matter was the subject of consideration by the Board of Tax Appeals, the assignment and contracts had been fully executed. *An assignment need not be in any particular form so long as it indicates the intention of the parties, and the assignment here in question not only indicates the intention of the parties, but all of the parties acquiesced therein and acted thereon.*" (Italics supplied)

In *Ketchum v. St. Louis*, 101 U. S. 306, 25 L. ed. 999, the court approved the following language of the trial court:

"If a debtor by a concluded agreement with a creditor sets apart a specific amount of a specific fund in the hands, or to come into the hands, of another from a designated source, and directs such person to pay it to the creditor, which he assents to do, this is a specific appropriation binding upon the parties and upon all persons with notice who subsequently claim an interest in the fund under the debtor."

In that case the agreement (embodied in a statute authorizing a loan to a railroad by a county and accepted by the debtor corporation) was that a state officer in charge of the funds of the railroad "shall, every month after said bonds are issued, pay into the County Treasury * * * out of the earnings of said Pacific Railroad, \$4000 and \$1000 additional in each month of December * * *." The State had an outstanding mortgage on the property, franchises, and income of company.

The court pointed out that, in the negotiations leading up to the making of the agreement, the County officials had suggested various other forms of security, and that in accepting the arrangement finally made,

they must have construed it as giving them such security. With reference to the language embodied in the statute, the court says:

“It was not a simple, naked covenant to pay out of a particular fund; but the Act, being accepted by the parties interested, operated as an equitable assignment of a fixed portion of that fund; an assignment which became effectual without any further intervention upon the part of the debtor, and which the party holding the funds of the company * * * could respect without liability to the debtor for so doing. * * * It was an engagement to pay out of a specially designated fund, accompanied by express authority to its custodian to apply a specific part thereof to a definite object, in the accomplishment of which all the parties to the arrangement were directly interested.”

(c) Summary.

An order to pay out of a specified fund has always been held to be a valid assignment in equity and to fulfill all the requirements of the law.

Christmas v. Russell, 14 Wall. 69, 20 L. ed. 762, 764.

Burke v. Child, 21 Wall. 441, 22 L. ed. 623, 624.

An assignment has been held good, even where the custodian of the fund was not given notice (*Barnes v. Alexander, supra*) and we know of no case where, the assignee having given consideration for such an order on the trustee or custodian of the fund, the assignment has not been held valid. An antecedent debt is sufficient consideration. *National Bank v. U. S. Security Life Ins. Co.*, 17 App. D. C. 112. Where the custodian of the fund is authorized to pay over future receipts to the assignee, and the latter then releases an attachment of the assignor's property, the arrange-

ment constitutes an assignment vesting the assignor's interest in the assignee, *pro tanto*. *In Re Ballantine* (D. C. Pa.), 179 Fed. 548. Certainly where the agreement provides for such an order on the trustee, and the assignee, in consideration thereof, gives up an undisputed interest in the remainder, there is a valid assignment, particularly in view of the well established rules that no particular words or special forms are necessary (*National Bank v. U. S. Security Life Ins. Co.*, *supra*); that the situation of the parties and the attendant circumstances indicating that the assignee would not have been satisfied with less than an assigned interest are entitled to great weight (*Eisenlohr v. Erich*, *supra*; *Ketchum v. St. Louis*, *supra*); and that, in case of doubt, the actions of the parties in construing the contract should control (*Iowa Bridge Company v. Commissioner*, *supra*; *Nelson v. Ferguson*, *supra*; *Sanborn v. Maxwell*, *supra*).

II. An Equitable Assignment of a Property Interest Relieves the Assignor of Tax on Future Income Therefrom.

All equitable assignments of income do not relieve the assignee of income tax liability thereon. Such assignments of future earnings from personal services of the assignor (*Luce v. Burnet*, ... App. D. C., 55 Fed. (2d) 751; *Parker v. Routzahn* (C. C. A. 6th), 56 Fed. (2d) 730), or of partnership earnings (*Lucas v. Earl*, 281 U. S. 111, 74 L. ed. 731) or of income where the assignor has and retains legal title and control of the income-producing property (*Bing v. Bowers*, (D. C. N. Y.) 22 Fed. (2d) 450), do not shift the tax burden to the assignee. However, the distinction between such cases and the instant case is apparent. Judge Learned

Hand, in *Lowery v. Helvering*, 70 Fed. (2d) 713, 715, speaking of cases of that kind, said:

“The choses in action there transferred were indeed as absolutely transferred as though they were unconditional in obligation; but they were conditional upon continued performance by the assignor, the original obligee. There is therefore a real propriety in looking at the obligee’s performance as the source of the income, though strictly his control over it is only negative * * *. However, it is not of consequence now just what is the rational foundation of the doctrine, for it has never been held to apply where the consideration has been performed and the right become absolute. In such situations an assignment is treated as completely stripping the assignor of his rights * * *.”

This Court, in *Hall v. Burnet*, ... App. D. C., 54 Fed. (2d) 443, had under consideration a case where the taxpayer had assigned to his wife certain sums out of income to accrue to him under a contract with an insurance company. The court said (p. 444):

“It was not an assignment of future earnings, but the transfer of a property right, and though this property right gave rise to future income, uncertain and contingent though it might be as to amount, that fact does not destroy the distinction. In this case, the contract between the appellant and the insurance company gave him a property right in all renewal premiums on all business written for the company by him or by others during the period of the contract. Undoubtedly, his right to these commissions would survive his death and would pass to his estate to the same extent and in the same way as other property which he then possessed. In these circumstances, it is obvious that the right was fixed and certain, and was independent of any future service to be rendered by him. Any uncertainty in the situation concerned

only the amount; but the agent's rights as against the insurance company were established. When, therefore, the contract was assigned to his wife, a property right passed to her, as capable of assignment as any other sort of property; for instance, as rents to accrue from a lease for a term of years, or royalties from a patent."

It has been held repeatedly that an income beneficiary of a trust estate has a property right, namely, the right to the income; that this right may be assigned, in whole or in part; and that when so assigned, amounts paid therefrom to the assignee are not taxable income of the assignor.

Commissioner v. Field, 42 F. (2d) 820

Young v. Gnichtel, 28 F. (2d) 789

O'Malley-Keyes v. Eaton, 24 F. (2d) 436

Shellabarger v. Commissioner, 38 F. (2d) 566

Lowery v. Helvering, *supra*.

In the instant case no element of personal service is involved; there was nothing remaining for the petitioner to do to bring income into being; the income itself was the accretion to a capital fund or corpus, which fund or corpus was under the management of trustees, and there was no right of management or control in the petitioner at any time; the assignment having once been made, could not be revoked; and Beulah Martin, not the petitioner, was the only person who could receive the annual payments of \$25,000.

CONCLUSION.

We respectfully submit that the decision below should be reversed.

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UNITED STATES
COURT OF APPEALS FOR THE
DISTRICT OF COLUMBIA

FILED SEP 2 1934

No. 6227

Henry H. Hodges

**In the United States Court of Appeals
for the District of Columbia**

APRIL TERM, 1934

JAMES McDONALD, PETITIONER

v.

**GUY T. HELVERING, COMMISSIONER OF INTERNAL
REVENUE, RESPONDENT**

**ON PETITION FOR REVIEW OF DECISION OF THE UNITED
STATES BOARD OF TAX APPEALS**

BRIEF FOR THE RESPONDENT

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**In the United States Court of Appeals
for the District of Columbia**

APRIL TERM, 1934

No. 6227

JAMES McDONALD, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL
Revenue, respondent

*ON PETITION FOR REVIEW OF DECISION OF THE UNITED
STATES BOARD OF TAX APPEALS*

BRIEF FOR THE RESPONDENT

OPINION BELOW

The only previous opinion in this case is that of the United States Board of Tax Appeals (R. 12-23), which is reported in 28 B.T.A. 1234.

JURISDICTION

This appeal involves income taxes for the year 1927 in the amount of \$5,152.07, and is taken from a judgment of the United States Board of Tax Appeals entered on November 13, 1933 (R. 24). By stipulation of the parties (R. 24) the case is

brought to this Court by petition for review filed February 12, 1934 (R. 25-31), pursuant to Sections 1001-1003 of the Revenue Act of 1926, c. 27, 44 Stat. 9, as amended by Section 1101 of the Revenue Act of 1932, c. 209, 47 Stat. 169.

QUESTION PRESENTED

The only question presented is whether the Board of Tax Appeals correctly construed a series of agreements executed by the petitioner and his former wife which he contends effected an assignment of income which relieves him of liability for income tax thereon.

STATUTE INVOLVED

Revenue Act of 1926, c. 27, 44 Stat. 9.

SEC. 213. For the purposes of this title, except as otherwise provided in section 233—

(a) The term "gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * *, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. The amount of all such items shall be included in the gross income for the taxable year in which received by the taxpayer, un-

less, under methods of accounting permitted under subdivision (b) of section 212, any such amounts are to be properly accounted for as of a different period. (U.S.C. App., Title 26, Sec. 954.)

STATEMENT

The facts found by the Board of Tax Appeals (R. 12-20) were based upon a stipulation of the parties (R. 32-45), and may be summarized as follows:

The petitioner's father died January 13, 1915, a resident of the District of Columbia, leaving a will and codicil which were admitted to probate in the Supreme Court of the District. The decedent's residuary estate was left in trust for the benefit of the petitioner and his children until the oldest surviving child should reach the age of thirty years, at which time the corpus was to be distributed, one-half to the petitioner and the other half to his children.

In 1922 the petitioner brought suit in the District of Columbia to have the will declared void on the ground that it violated the rule against perpetuities. The suit was dismissed by the Supreme Court of the District and an appeal taken to this Court. While this appeal was pending the petitioner and Beulah Martin, his wife, entered into a written agreement (R. 38-42) dated December 11, 1924, for the purpose of fixing, settling, and determining their respective property rights. This agreement was apparently prepared in the belief that

the provisions of his father's will creating a testamentary trust for the benefit of petitioner and his children would be held void and the petitioner would become entitled to the whole of the residuary estate, or that the will would be held valid and the action of the trustees in administering the trust would be approved. Paragraph 4 of the agreement provided that in event the petitioner should succeed to the decedent's estate as heir at law he would assign an undivided half interest in the property in trust for the benefit of his two sons and Paragraph 5 provided that if a child or children should thereafter be born to the petitioner who would be entitled to share in the residuary estate of the decedent the petitioner would convey to his two sons from his separate estate sums equal to the amounts by which their inheritances would be reduced as a result of the birth of such child or children. Paragraph 6 of the agreement confirmed and continued a prior assignment of \$1,000 per month to his wife from an annuity payable to the petitioner under the terms of the decedent's will.

Paragraph 7 of the agreement, which has been given special consideration in this proceeding, reads as follows (R. 41-42):

7. The party of the first part shall and will, in addition to the payments hereinbefore specified, pay to the party of the second part the sum of Four Hundred Thousand Dollars (\$400,000) in lawful money of the United States, in full settlement of all

claims and demands of every kind or character now existing or which but for this agreement might hereafter arise. The said payment of Four Hundred Thousand Dollars (\$400,000) by the party of the first part shall be made to the party of the second part when the party of the first part becomes entitled to his share of the estate of James McDonald, Sr., whether he shall become so entitled thereto pursuant to the provisions of said last will and testament of James McDonald, Sr., deceased, or as his heir at law, or prior thereto if the said party of the first part so elects. For the purpose of further assuring the payment of said Four Hundred Thousand Dollars (\$400,000) to the party of the second part said party of the first part does hereby assign, transfer, and set over to the said party of the second part an interest in his share of the property of the estate of James McDonald, Sr., in the amount of Four Hundred Thousand Dollars (\$400,000) and directs the trustees named in the will of James McDonald, Sr., or their successors, to pay and deliver to the party of the second part, whenever such payment may be by such trustees lawfully made, the said sum of four Hundred Thousand Dollars (\$400,000), and in the event that the trust provisions of said will shall hereafter finally be declared void or the said party of the first part shall for any other reason succeed to the estate of James McDonald, Sr., then the executor of said last will and testament and the court in which the administration of said estate is

then pending are, and such executor and such court is hereby authorized, empowered and directed to cause to be distributed and paid to the said party of the second part the said sum of Four Hundred Thousand Dollars (\$400,000).

The agreement concluded with a provision that an executed copy thereof should be filed with the trustees.

At some time between the date of execution of the above agreement and December 21, 1925, the petitioner and his wife were divorced. On the latter date a second agreement was executed by the petitioner and his former wife. This second agreement reads as follows (R. 43-45):

It is agreed by and between the parties hereto as follows:

In the event that the suit now pending on appeal in the Court of Appeals in the District of Columbia involving the validity of the will of James McDonald, Sr., the court should so construe the will as to hold that the testator intended only to include as his legatees his son James McDonald and his two grandchildren living at the time of the testator's death, namely—James McDonald, Jr., and Robert Alexander McDonald; and should further hold that all of the contingent legatees named in paragraphs M, N, O, and P of said will, except the same James McDonald and the said two children above named, take no interest whatever under said will, and provide further that an arrange-

ment is made whereby one-half of the accumulated income now in the hands of the executors and trustees may be paid over to the said James McDonald, and the further payment of one-half of said income as it accumulates may be paid to the said James McDonald, then in such event it is agreed by and between the parties hereto as follows:

1. That all the costs and other expenses incident to the prosecution of said suit in the Supreme Court of the District of Columbia and in the Court of Appeals of said District, including counsel fees of plaintiff, the defendant, Beulah McDonald, and guardian ad litem for said minor defendants, be first paid out of the entire accumulated income.

2. And out of the accumulated income payable to James McDonald there will be paid to Beulah Martin the sum of One Hundred Fifty Thousand (\$150,000) Dollars, One Hundred Thousand (\$100,000.00) Dollars of which is to be applied as a credit on a contract entered into by and between the parties hereto on the 11th day of December 1924, under the terms of which said Beulah Martin is to be paid Four Hundred Thousand (\$400,000.00) Dollars. The other Fifty Thousand (\$50,000.00) Dollars to be in full payment for household furniture, paintings, works of art, etc., heretofore given to the said Beulah Martin by the said James McDonald, said property to be returned to the said James McDonald in the event he cares to exercise the option to repurchase the same

(this not to include family jewels). In the event said James McDonald does not care to exercise the option to pay Fifty Thousand (\$50,000.00) Dollars for said property, then the said Beulah Martin is to receive the sum of One Hundred Fifty Thousand (\$150,000.00) Dollars to be applied as a credit on the Four Hundred Thousand (\$400,000.00) provided in said contract of December 11, 1924. After the application of the above payment as a credit on said contract, then said Beulah Martin agrees to accept the sum of Twenty-five Thousand (\$25,000.00) Dollars per year direct to the said Beulah Martin until the balance of said Four Hundred Thousand (\$400,000.00) Dollars is liquidated.

3. It is further agreed in the event said decree is entered that said contract of December 11th, 1924, will be novated and reformed by the elimination of all of paragraphs 5, 6, and 7, and the copy of said contract now on file with the Fulton Trust Company of New York will be withdrawn and another contract executed and filed in its stead in accordance with the stipulation herein.

4. The Four Hundred Thousand (\$400,000.00) Dollar settlement provided in paragraph 7 of said contract of December 11th, 1924, includes a note of Two Hundred Thousand (\$200,000.00) Dollars heretofore executed by the said James McDonald and payable to Beulah Martin, and note having been executed so that the annual interest thereon would guarantee the payment of the

One Thousand (\$1,000.00) Dollars per month referred to in paragraph 6 of said contract. Upon the execution of said settlement as herein outlined, said One Thousand (\$1,000.00) Dollars per month will cease and said note of Two Hundred Thousand (\$200,000.00) Dollars will be surrendered by said Beulah Martin to James McDonald.

On February 2, 1926, the petitioner and Beulah Martin entered into a third agreement relating to this same subject matter which, after reciting the making of the agreement of December 21, 1925, provided as follows (R. 34-36):

Further negotiations looking to the settlement of the suit now pending on appeal in the Court of Appeals of the District of Columbia involving the validity of the Will of James McDonald, Sr., referred to in such memorandum of agreement, have shown that "the entire accumulated income" possibly cannot be applied to the payment of costs and other expenses incident to the prosecution of said suit, but that there can possibly be used for said purposes only the one-half of such entire accumulated income that will be awarded to James McDonald, Jr.; as a result it may become necessary to modify and amend paragraphs 1 and 2 of such memorandum of agreement. Accordingly, and in such event, paragraph 1 of such agreement will be modified and amended to read as follows:

That such costs as may be adjudged against James McDonald in the Supreme Court of the District of Columbia and in the Court of Appeals of said District shall be first paid out of the one-half of the said accumulated income to be distributed to the said James McDonald; also the expenses incurred by the said James McDonald in the prosecution of said suit; and the attorneys' fees incurred by the said James McDonald in the prosecution of the said suit, which shall include Twenty Thousand (\$20,000) Dollars to be paid to U. S. Webb, as attorney for Beulah McDonald (now Beulah Martin) the balance of said fee of said Webb to be paid by the said Beulah Martin.

Paragraph 2 of said memorandum of agreement so signed and executed as aforesaid is hereby modified and amended to read as follows:

"And out of the accumulated income payable to James McDonald there will be paid to Beulah Martin the sum of One Hundred Thousand (\$100,000.00) Dollars, which shall be applied as a credit on a contract entered into by and between the parties hereto on the 11th day of December 1924, under the terms of which said Beulah Martin is to be paid Four Hundred Thousand (\$400,000.00) Dollars. After the application of the above payment of One Hundred Thousand (\$100,000.00) Dollars as a credit on said contract, then said Beulah Martin agrees to accept the sum of Twenty-five Thousand (\$25,000.00) Dollars per year, without interest, on said

contract, until the said total sum of Four Hundred Thousand (\$400,000) Dollars shall have been fully paid, and an order shall be given to the Fulton Trust Company of New York to make to Beulah Martin the said payments of Twenty-five Thousand (\$25,000.00) Dollars per year direct to her until the balance of said sum of Four Hundred Thousand (\$400,000.00) Dollars shall have been fully paid.

“Said payments of Twenty-five Thousand (\$25,000) Dollars per year shall be made to Beulah Martin for and during the period of twelve years, unless within that period the one-half of the property of said estate should be delivered to said James McDonald, Jr., and in that event the Fulton Trust Company shall at such date pay to Beulah Martin such sum as will complete the total of Four Hundred Thousand (\$400,000.00) Dollars.”

Paragraphs 1 and 2 as herein amended and modified shall be construed as substituted for paragraphs 1 and 2 as contained in the original memorandum of agreement, and in all other respects said original memorandum of agreement is reapproved and reaffirmed. Executed in duplicate.

On May 3, 1926, this Court entered its decree in the petitioner's suit (*McDonald v. Maxwell*, 12 F. (2d) 822, 825), as follows (R. 33):

(1) That upon the death of the testator, James McDonald, the appellant, James McDonald, Jr., took a present vested interest in the undivided one-half of the testator's

That such costs as may be adjudged against James McDonald in the Supreme Court of the District of Columbia and in the Court of Appeals of said District shall be first paid out of the one-half of the said accumulated income to be distributed to the said James McDonald; also the expenses incurred by the said James McDonald in the prosecution of said suit; and the attorneys' fees incurred by the said James McDonald in the prosecution of the said suit, which shall include Twenty Thousand (\$20,000) Dollars to be paid to U. S. Webb, as attorney for Beulah McDonald (now Beulah Martin) the balance of said fee of said Webb to be paid by the said Beulah Martin.

Paragraph 2 of said memorandum of agreement so signed and executed as aforesaid is hereby modified and amended to read as follows:

"And out of the accumulated income payable to James McDonald there will be paid to Beulah Martin the sum of One Hundred Thousand (\$100,000.00) Dollars, which shall be applied as a credit on a contract entered into by and between the parties hereto on the 11th day of December 1924, under the terms of which said Beulah Martin is to be paid Four Hundred Thousand (\$400,000.00) Dollars. After the application of the above payment of One Hundred Thousand (\$100,000.00) Dollars as a credit on said contract, then said Beulah Martin agrees to accept the sum of Twenty-five Thousand (\$25,000.00) Dollars per year, without interest, on said

contract, until the said total sum of Four Hundred Thousand (\$400,000) Dollars shall have been fully paid, and an order shall be given to the Fulton Trust Company of New York to make to Beulah Martin the said payments of Twenty-five Thousand (\$25,000.00) Dollars per year direct to her until the balance of said sum of Four Hundred Thousand (\$400,000.00) Dollars shall have been fully paid.

“Said payments of Twenty-five Thousand (\$25,000) Dollars per year shall be made to Beulah Martin for and during the period of twelve years, unless within that period the one-half of the property of said estate should be delivered to said James McDonald, Jr., and in that event the Fulton Trust Company shall at such date pay to Beulah Martin such sum as will complete the total of Four Hundred Thousand (\$400,000.00) Dollars.”

Paragraphs 1 and 2 as herein amended and modified shall be construed as substituted for paragraphs 1 and 2 as contained in the original memorandum of agreement, and in all other respects said original memorandum of agreement is reapproved and reaffirmed. Executed in duplicate.

On May 3, 1926, this Court entered its decree in the petitioner's suit (*McDonald v. Maxwell*, 12 F. (2d) 822, 825), as follows (R. 33):

(1) That upon the death of the testator, James McDonald, the appellant, James McDonald, Jr., took a present vested interest in the undivided one-half of the testator's

estate after the payment of debts, specific legacies, annuities, and costs of administration, the corpus thereof to be paid to said James by the executors under the will when his oldest child living at the testator's death shall reach the age of 30 years.

(2) That pending the payment to said James of the principal of his one-half interest in said estate he is entitled to receive, and the said executors and trustees shall pay to him, in addition to the annuity provided for him by the codicil of said will, the cash income upon the said one-half interest accrued thereon to this date and the future cash income thereon from time to time as the same shall accrue hereafter.

(3) That upon the death of the testator, James McDonald, the infant defendants and appellees, James McDonald, 3d, and Robert Alexander McDonald, took a present vested interest in the remaining one-half of the estate of said testator after the payment of debts, specific legacies, annuities, and costs of administration, the same to be divided between them, share and share alike, such division and distribution to be made when the oldest of said children shall reach the age of 30 years, and otherwise provided by the terms of the will.

Pursuant to the decree there was paid to the petitioner in 1926, by the trustees, an amount in excess of \$500,000 representing his half of the accumulated income of the trust to that date. Out of this sum the petitioner paid to Beulah Martin the \$100,-

000 in cash provided for in paragraph 2 of the agreement of December 21, 1925, as modified by the agreement of February 2, 1926 (R. 18, 34).

The trustees filed a fiduciary return for 1927 on Form 1041 in which the following was reported (R. 19, 36):

Profit from sale of stocks and bonds-----	\$6,856. 12
Interest and miscellaneous income-----	23,544. 98
Dividends -----	181,104. 60
	<u>211,505. 70</u>
Deductions: Taxes, Trustees' Commissions-----	31,914. 23
Net income-----	<u>179,591. 47</u>

The return indicated the following distribution:

	Dividends	Balance
James McDonald, Hailey, Idaho-----	\$90,552. 30	(\$4,184. 62)
Fulton Trust Co. of New York, trustee for James McDonald, 3d and Robert Alex McDonald, 149 Broadway, New York City-----	90,552. 30	(4,184. 63)
Fulton Trust Co. of New York and Joseph S. Graydon, Trustees (profit from sale)-----		6,856. 12

The trustees filed a return on Form 1040 upon which they reported the \$6,856.12 profit from sale of corpus, and paid a tax thereon. They also filed another return on Form 1040 as trustees for the petitioner's two sons in which they reported and paid tax on the \$90,522.30 dividends, less the \$4,184.63, one-half of the loss accruing to the sons. The trustees filed no return on Form 1040 for the petitioner, nor did they pay any tax on the \$90,552.30 dividends, less the loss of \$4,184.63 accruing to the petitioner (R. 19, 36).

The petitioner, in filing his income-tax return for the year 1927, reported as dividends the sum of \$90,552.30 and deducted the \$4,184.63 loss. In-

cluded in the item "Other Deductions" on his return the petitioner included the following:

"Division of Income, former wife Beulah Martin \$25,000", representing that sum which the trustees, pursuant to the provisions of the above agreements, paid out of the \$90,552.30 to Beulah Martin in that year. In determining the deficiency in controversy the respondent disallowed this deduction. The action of the Board of Tax Appeals in sustaining this disallowance is assigned as error here (R. 19, 36-37).

SUMMARY OF ARGUMENT

Petitioner was a beneficiary under a trust created by the will of his father. The trust income had been accumulated by the trustees for a number of years. In 1926 the Court of Appeals of the District of Columbia held that petitioner was then entitled to receive his share of the accumulated income, and that he was entitled to receive his share of the future income as it accumulated.

Petitioner's right to receive future income of the trust was an equitable estate for years and present proper alienable like any other property. When received, such income was taxable to him. He could not, by assignment or otherwise, dispose of the income in advance of its receipt in order to avoid income tax thereon without also disposing of the property itself—the right to receive the income as it accumulated.

Petitioner contracted in writing to pay \$400,000 to Beulah Martin, his wife, when he became en-

titled to receive his share of the trust property. Modifying agreements, executed in anticipation of the court's decision ordering distribution to him of his share of accumulated and future income, provided that petitioner should pay \$100,000 of the \$400,000 when he received his share of the accumulated income, and that the balance should be paid in twelve annual installments of \$25,000 each, payment to be made direct to her by the trustees, unless petitioner should receive his share of the trust corpus within that period in which event the unpaid balance would be paid. These modifying agreements do not purport to be assignments of petitioner's right to receive any part of his share of the trust income, but merely provide a method of convenient payment of the amount specified in the original contract with Beulah Martin.

Not having parted with title to any part of his equitable estate for years—the right to receive income—petitioner is taxable on the entire amount distributable to him.

ARGUMENT

I

Petitioner cannot avoid taxation on future income from property without parting with title to the income-producing property

This case presents the familiar situation of a taxpayer taking the position that because of certain agreements concerning the disposition of future in-

come to which he may become entitled he is relieved of liability for the income tax thereon.

The petitioner was a beneficiary to the extent of a one-half interest in a trust created in 1915 by the will of his father. The trustees named in the decedent's will had held the trust property and accumulated the income thereon without making any distribution to the beneficiaries, until after May 3, 1926. In the meantime the petitioner had instituted an action in 1922 to have that part of his father's will set aside as a violation of the rule against perpetuities, and to have himself declared the sole heir of his father and entitled to the property held in trust. This suit was settled by the entry of a judgment in this Court on May 3, 1926, which declared the decedent's will valid but held that the petitioner was then entitled to receive his half of the cash income accumulated to date and that thereafter he should be paid his half of the income as it accumulated. *McDonald v. Maxwell*, 12 F. (2d) 822 (App.D.C.).

While the petitioner's action was pending in this Court on appeal, he and Beulah Martin entered into the three written agreements which give rise to the instant controversy. The first contract of December 11, 1924, was obviously executed in anticipation of a dissolution of their marriage. In addition to certain other provisions for his wife and their children the petitioner agreed to pay his wife the sum of \$400,000 in cash. This sum was to be paid when he became entitled to his share of the estate

of his father, or earlier at his election. The agreements of December 21, 1925, and February 2, 1926, were excuted after the petitioner and his wife had been divorced, and apparently with the expectation that the petitioner would become entitled to receive his share of the trust income in advance of distribution of the trust corpus.

Under the terms of these later agreements the petitioner was to pay Beulah Martin \$100,000 out of the accumulated income of the trust to be applied as a credit against the \$400,000, and the balance was to be paid \$25,000 annually. The agreement of December 21, 1925, stated that (R. 44):

* * * then said Beulah Martin agrees to accept the sum of Twenty-five thousand (\$25,000) Dollars per year direct to the said Beulah Martin until the balance of said Four Hundred Thousand (\$400,000) Dollars is liquidated.

The modifying agreement of February 2, 1926, provided that (R. 35):

* * * then said Beulah Martin agrees to accept the sum of Twenty-five Thousand (\$25,000) Dollars per year, without interest, on said contract, * * * and an order shall be given to the Fulton Trust Company of New York to make to Beulah Martin the said payments of Twenty-five Thousand (\$25,000) Dollars per year direct to her until the balance of said Four Hundred Thousand (\$400,000) Dollars shall have been fully paid.

With respect to the nature of the petitioner's interest in the trust estate the Board said (R. 20):

The nature of the petitioner's interest in the estate is defined by the decree of the Court of Appeals of the District of Columbia, namely, a present vested interest in an undivided one-half of the residuary estate, entitling the petitioner to receive one-half of the cash income during the life of the trust, and one-half of the corpus upon its termination when his oldest child living at the testator's death reached the age of 30 years. *McDonald v. Maxwell*, 12 F. (2d) 822. His interest in the income—his right to the income—was an equitable estate for years and present property, alienable at common law like any other, in the absence of restraint on alienation. *Commissioner v. Field*, 42 Fed. (2d) 822; *Edith R. Wood*, 27 B.T.A. 1308, District of Columbia Code, secs. 1, 1017, 1030, 1032, 1036, 1640; *Lisner v. Hughes*, 49 App. D.C. 40. It does not appear that the will imposed any restraint on alienation.

In this proceeding the petitioner contends that the written agreements between himself and Beulah Martin constituted an irrevocable assignment of an interest in that estate which divested him of a property interest and the right to receive the income which was paid to his wife (R. 30; Br. 7). The respondent contends, and the Board of Tax Appeals held, that the agreements in question did not have this effect.

It may be admitted for the purposes of this appeal that the petitioner's right to receive one-half of the future income of the trust as it accumulated constituted property, or a right in property, which he could alienate. It may further be admitted that if the agreements in question constituted an irrevocable assignment or transfer of an undivided part of that property right the income paid to his wife would not be taxable to the petitioner. This is based upon the well-settled principle that an assignment of property or property rights relieves the assignor of the tax on income subsequently arising therefrom, since both the property and the income no longer belong to him. *Nelson v. Ferguson*, 56 F. (2d) 121 (C.C.A. 3d), certiorari denied, 286 U.S. 565; *Helvering v. Seatree* (App.D.C.), decided June 4, 1934, not officially reported but found in 343-A, C.C.H., par. 9320; *Lowery v. Helvering*, 70 F. (2d) 713 (C.C.A. 2nd); *Hall v. Burnet*, 54 F. (2d) 443 (App.D.C.), certiorari denied, 285 U.S. 552; *Commissioner v. Field*, 42 F. (2d) 820 (C.C.A. 2nd); *Iowa Bridge Co. v. Commissioner*, 39 F. (2d) 777 (C.C.A. 8th); *Shellabarger v. Commissioner*, 38 F. (2d) 566 (C.C.A. 7th); *Young v. Gnichtel*, 28 F. (2d) 789 (N.J.); *O'Malley-Keyes v. Eaton*, 24 F. (2d) 436 (Conn.); *Leydig v. Commissioner*, 15 B.T.A. 124, affirmed, 43 F. (2d) 494 (C.C.A. 10th), as to income held taxable to assignor; *Simms v. Commissioner*, 28 B.T.A. 988.

On the other hand, it is equally well settled that, notwithstanding the validity and enforceability of

an agreement as between the contracting parties, the liability for income tax upon future income or profits which will or may accrue to the assignor by reason of the ownership of an interest in property cannot be avoided by the grantor by assignment of such income or profits to another. *Burnet v. Leininger*, 285 U.S. 136; *Corliss v. Bowers*, 281 U.S. 376; *Lucas v. Earl*, 281 U.S. 111; *Saenger v. Commissioner*, 69 F. (2d) 631 (C.C.A. 5th); *O'Donnell v. Commissioner*, 64 F. (2d) 634 (C.C.A. 9th), certiorari denied, 290 U.S. 699; *Jackson v. Commissioner*, 64 F. (2d) 359 (C.C.A. 4th); *Daugherty v. Commissioner*, 63 F. (2d) 77 (C.C.A. 9th); *Van Meter v. Commissioner*, 61 F. (2d) 817 (C.C.A. 8th); *Power v. Commissioner*, 61 F. (2d) 625 (C.C.A. 8th), certiorari denied, 288 U.S. 612; *Ward v. Commissioner*, 58 F. (2d) 757 (C.C.A. 9th), certiorari denied, 287 U.S. 656; *Lansill v. Burnet*, 58 F. (2d) 512 (App.D.C.); *Parker v. Routzahn*, 56 F. (2d) 730 (C.C.A. 6th), certiorari denied, 287 U.S. 606; *Luce v. Burnet*, 55 F. (2d) 751 (App.D.C.); *Bishop v. Commissioner*, 54 F. (2d) 298 (C.C.A. 7th); *Leydig v. Commissioner*, 43 F. (2d) 494 (C.C.A. 10th); *Rosenwald v. Commissioner*, 33 F. (2d) 423 (C.C.A. 7th), certiorari denied, 280 U.S. 599; *Bing v. Bowers*, 22 F. (2d) 450 (S.D. N.Y.), affirmed, 26 F. (2d) 1017 (C.C.A. 2nd); *Mitchell v. Bowers*, 9 F. (2d) 414 (S.D.N.Y.), affirmed, 15 F. (2d) 287 (C.C.A. 2nd), certiorari denied, 273 U.S. 759; *Winder v. Commissioner*, 17 B.T.A. 303, and cases cited.

In his return for 1927 the petitioner included as gross income the \$25,000 item in controversy and claimed the same amount as a deduction under Section 214 of the Revenue Act of 1926. There is no provision in Section 214 of that Act under which this amount can be claimed as a deduction and petitioner's argument, both here and below, is based upon the ground that this sum does not constitute a part of his gross income. See Section 213 of the Revenue Act of 1926. To sustain this position he relies upon the written agreements in question as constituting an absolute assignment of his right to receive this income.

Income has been defined as "the gain derived from capital, from labor, or from both combined." *Eisner v. Macomber*, 252 U.S. 189, 207, and cases cited. In the instant case the income involved is gain derived from capital. The cases cited above include instances of the assignment of each of these classes of income. In *Van Meter v. Commissioner*, 61 F. (2d) 817 (C.C.A. 8th), the court said (pp. 818-819):

The "earner" of income is one whose personal efforts have produced it; who owns property which produced it or a combination of the two. Decisions of the Supreme Court have declared that the income statutes require taxation to the earner in each of the three above sources of income where the income was actually realized but never came to beneficial enjoyment by the earner. *Lucas v. Earl*, 281 U.S. 111, 50 S.Ct. 241, 74

L.Ed. 731, is the decision in the instance of income earned by personal efforts alone—the income there being fees and salary of an attorney. *Corliss v. Bowers*, 281 U.S. 376; 50 S.Ct. 336, 74 L.Ed. 916, is the instance of income from owned property. *Burnett v. Leininger*, 285 U.S. 136, 52 S.Ct. 345, 76 L.Ed. 665, is the instance of combined personal effort and property (or capital).

* * *

* * * The rule and intent of the taxing statutes is that the earner of income which he might and, normally, would receive and enjoy for himself is not relieved because he chooses not to receive or not to enjoy it, and this is not necessarily changed by such deprivation taking the form of an obligation legally binding him thereto. If there exists a legal relationship of the earner to others which results in the earnings (in part or whole) being for the benefit of others than the actual earner, the statutes do not attempt to tax the earner for such income as he was not earning in his own right, but where the earner of the income does nothing more than transfer the income earned in his own right to another, even though such disposal be in advance of the earning thereof (*Burnet v. Leininger* and *Lucas v. Earl*, *supra*), or where he retains any power of control over the income earning property or the income therefrom (*Corliss v. Bowers*, 281 U.S. 376, 50 S.Ct. 336, 74 L.Ed. 916, and analogous as to transfer tax *Chase Nat. Bank v. U.S.*, 278 U.S. 327, 49 S.Ct. 126, 73 L.Ed. 405, 63

A.L.R. 388; *Reinecke v. Northern Trust Co.*, 278 U.S. 339, 49 S.Ct. 123, 73 L.Ed. 410, 66 A.L.R. 397, and as to State succession tax *Saltonstall v. Saltonstall*, 276 U.S. 260, 48 S.Ct. 225, 72 L.Ed. 565), such income is taxable to him within the intent of the statute (*Burnet v. Leininger*, *Lucas v. Earl*, and *Corliss v. Bowers*, *supra*).

In *Saenger v. Commissioner*, 69 F. (2d) 631 (C.C.A. 5th), the court said (pp. 632, 633):

The rule of the *Earl* Case, while made graphic by a figure, is more than a figure of speech. It is an expression of the simple truth that earned incomes are taxed to and must be paid by those who earn them, and unearned incomes to those who own the property or right that produced them, not to those to whom their earners or owners are under contract to pay them. It establishes once for all that no device or arrangement, be it ever so shrewdly and cunningly contrived, can make future earnings taxable to any but the real earner of them, can make future incomes from property taxable to any but the owner of the right or title from which the income springs. *Corliss v. Bowers*, 281 U.S. 376, 50 S.Ct. 336, 74 L.Ed. 916; *Burnet v. Leininger*, 285 U.S. 142, 52 S.Ct. 345, 76 L.Ed. 665; *Burnet v. Guggenheim*, 288 U.S. 280, 53 S.Ct. 369, 77 L.Ed. 748; *Reinecke v. Smith*, 289 U.S. 177, 53 S.Ct. 570, 77 L.Ed. 1109; *Burnet v. Wells*, 289 U.S. 677, 53 S.Ct. 761, 77 L.Ed. 1439; *Van Meter v. Com'r* (C.C.A.) 61 F. (2d) 817;

Daugherty v. Com'r (C.C.A.) 63 F. (2d) 77, 78; *Blumenthal v. Com'r* (C.C.A.) 60 F. (2d) 715; *Reynolds v. McMurray* (C.C.A.) 60 F. (2d) 843; *Pedder v. Com'r* (C.C.A.) 60 F. (2d) 866.

The rule does not make taxable to one the income of another. It operates to prevent this occurring. If what is done in any case, no matter what form of words is used amounts to the transfer of the right or title to that from which the income springs, the income follows the right. Likewise, if compensation paid to one is paid to him as the agent or servant in fact, not in fiction, of another, that income is taxable, not to the servant or agent as earner, but to its real earner, the principal. [Citations]

In *Bing v. Bowers*, 22 F. (2d) 450 (S.D. N.Y.), affirmed 26 F. (2d) 1017 (C.C.A. 2d), the taxpayer had assigned to his mother an annuity out of his share of the income from certain properties, in whole or in part, owned by him. In holding the income taxable to the assignor the District Court said (p. 454):

To permit the assignor of future income from his own property to escape taxation thereon by a gift grant in advance of the receipt by him of such income would by indirection enlarge the limited class of deductions established by statute. As long as he remains the owner of the property, the income therefrom should be taxable to him as fully, when he grants it as a gift in advance

of its receipt, as it clearly is despite a gift thereof immediately after its receipt.

In *Leydig v. Commissioner*, 15 B.T.A. 124, the Board of Tax Appeals, after citing a number of cases dealing with each side of this question, stated the principle as follows (p. 132):

The cases collected above are singularly free from conflict as to the principle governing the issue raised. From them we conceive the rule to be that income *per se* cannot be assigned to relieve the assignor of the tax levy, but, where the thing assigned was a property right, real or personal, productive of income, income thereafter arising from such property is income to the assignee by virtue of his ownership. * * *

II

The record in this appeal fails to disclose an unqualified assignment of property which will relieve petitioner of the tax on future income therefrom

It is clear that petitioner cannot escape taxation merely by the assignment of income to be received in the future. If he is to be relieved of the tax here in controversy it is because the contracts executed by him and Beulah Martin effect an absolute and irrevocable assignment, to the extent of \$25,000 annually, of petitioner's right to receive his share of the income from his father's estate.

The form of an assignment is immaterial. In this case, if there was an assignment, it was in writing. However, in order to constitute an assign-

ment there must be an absolute appropriation, actual or constructive, by the assignor of the subject matter to the assignee, based on a valuable consideration and with the intention on the one side to assign and on the other to receive. *Eisenlohr v. Ehrich*, 296 Fed. 816 (C.C.A. 3d), certiorari denied, 265 U.S. 584. The record in the instant case is not sufficient to justify a decision that these requirements have been met.

Determination of the issue here involved must be based entirely upon the language of the three agreements in evidence. In construing them the Board said (R. 21-22):

No contention is made by the petitioner that he assigned any part of his interest in the corpus of the estate, and it is necessary to consider only whether the agreements divested him of part of his interest in the income.

In our opinion, the agreements do not disclose any transfer of the right to receive income. The first agreement of December 11, 1924, as well as the subsequent modifications, was primarily an agreement of the petitioner to pay his wife the fixed sum of \$400,000 in full settlement of any claims on his property which she might have by reason of the marriage relation. When the promise was made the petitioner was assured of part of the estate, either as heir or under the will. The amount was payable only when he became "entitled to his share of the estate", with the right to pay prior thereto if he so

elected. To assure payment he in present terms assigned to his wife "an interest in his share of the property of the estate" in the amount of \$400,000. Clearly, the latter provision was not an absolute and irrevocable assignment. If petitioner had elected to pay the full amount from his individual funds prior to settlement of the suit, or if he had paid out of property received from the trustees, the assignment would have become inoperative. Furthermore, the assignment is of part of petitioner's share of the property, and this might be construed to include his share of the corpus rather than of the income.

However this may be, we believe the petitioner's rights must be determined in the light of the 1925 and 1926 agreements. Those agreements were made on the condition, among others, that the court of appeals should adjudge the petitioner to be entitled to one-half the accumulated and future income and that an arrangement should be made whereby petitioner should be paid his share of the then accumulated income and his share of the future income. The conditions happened and the agreements became operative. They provided for payment out of the accumulated income of \$100,000, to be credited on the obligation of \$400,000; "that said Beulah Martin agree to accept the sum of * * * \$25,000 per year, without interest, on said contract [of December 11, 1924] until the said total sum of * * * \$400,000 shall have been fully paid"; and

that the payments of \$25,000 per year shall be made for a period of 12 years, but in the event one-half of the property or corpus of the estate should be delivered to petitioner within that period, a sum equal to the unpaid balance should be paid to her by the trustee. By express terms these agreements eliminated from the contract of the parties the provision of the December 11, 1924, agreement, assigning an interest in petitioner's "share of the property of the estate" to assure payment of the \$400,000. There are no substituted words of assignment. In our opinion, the petitioner merely promised to make payments to his wife out of distributions to be received by him from the estate. With respect to the payment of \$100,000, this was to be paid "out of the accumulated income payable to James McDonald." No direction was given the trustees to make this payment. They paid over \$500,000 to petitioner, and he in turn paid the \$100,000 to his wife. With respect to the payments of \$25,000 per year, with which we are primarily concerned, there is no specific designation of the source, but it is clear that the parties intended that they should be made out of the petitioner's share of the future income, or, if the trust should terminate within 12 years, that the unpaid balance be paid out of either income or corpus. The entire agreement discloses an intention to make the payments out of income (or property, if the trust terminated before 12 years), which first became income of the

petitioner. There is nothing which indicates that petitioner made any transfer or assignment of his right to income. We perceive no material difference between the agreement and that involved in *Marion Stone Burt Lansill*, 17 B.T.A. 413; affd., 58 Fed. (2d) 572. As in that case, the order to the trustees to make the payment direct to petitioner's wife, if it was in fact given, was but a convenient method of payment.

No exception is taken to those cases cited by petitioner (Br. 10-17) dealing with what constitutes a valid and enforceable assignment of a right in property. In each of those cases the basic facts show not only that the property or property rights involved were such as could be assigned, but the further fact that the assignor had in each case actually parted with all or a part of his title to the income-producing property. The evidence in the instant case is insufficient to establish the fact that petitioner actually parted with any part of his title to the income-producing property—his right to receive one-half of the trust income.

The first agreement between the petitioner and Beulah Martin, insofar as material here, provided that the petitioner (R. 41)—

* * * shall and will, in addition to the payments hereinbefore specified, pay to the party of the second part [Beulah Martin] the sum of Four Hundred Thousand Dollars (\$400,000) in lawful money of the United States, in full settlement of all claims and

demands of every kind or character now existing or which but for this agreement might hereafter arise.

Payment was to be made by the petitioner when he became entitled to his share of the estate of his father, or prior thereto at his election. As security for this payment, and for no other purpose, he assigned to her an interest in the trust property in the amount of \$400,000.

The second agreement, executed December 21, 1925, still contemplated the payment of \$400,000 in cash by the petitioner. But there is no language in the second agreement which can be construed as purporting to assign to the wife any right to receive any specified part of the income from the trust estate, even as security for future payments. The language of the agreement is indefinite, but if in any subsequent year the trust income should be insufficient to pay \$25,000 the courts would no doubt hold petitioner liable to make payment from his personal funds under the provision that (R. 44) :

After the application of the above payment as a credit on said contract, then said Beulah Martin agrees to accept the sum of Twenty-five Thousand (\$25,000) Dollars per year direct to the said Beulah Martin until the balance of said Four Hundred Thousand (\$400,000) Dollars is liquidated.

There is nothing in this language to even indicate an intention to make an assignment of the peti-

tioner's right to receive any part of his share of the trust income.

The agreement of February 2, 1926, is hardly more specific in this respect. It merely provides that after the credit of \$100,000 (R. 35):

* * * then said Beulah Martin agrees to accept the sum of Twenty-five Thousand (\$25,000) Dollars per year, without interest, on said contract until the said total sum of Four Hundred Thousand (\$400,000) Dollars shall have been fully paid, and an order shall be given to the Fulton Trust Company to make to Beulah Martin the said payment of Twenty-five Thousand (\$25,000) Dollars per year direct to her until the balance of said sum of Four Hundred Thousand (\$400,000) Dollars shall have been fully paid.

None of the cases cited by petitioner (Br. 10-17) are authority for the proposition that an agreement containing only a provision to the effect that an order will be given the trustees directing them to pay trust income to a third party constitutes an assignment of the right to receive that income in the first instance. As further indication of the fact that no absolute assignment of the right to receive income, this same agreement provides that if "one-half of the property of said estate *should be delivered to*" petitioner within twelve years the trustees "shall at such date pay to Beulah Martin" the unpaid balance of the \$400,000 (R. 35).

These agreements are all singularly lacking in the language ordinarily used in written assignments or conveyances and written agreements to assign or convey. There is nothing in any of these written documents which can be construed as an absolute assignment or conveyance of an interest in property to the extent claimed. Nor do the agreements, standing alone, disclose any intention on the part of the petitioner to make an assignment and on the part of Beulah Martin to accept an assignment of the right to receive income. On the other hand, they do clearly disclose an agreement on the part of the petitioner to pay, and on the part of Beulah Martin to accept, \$400,000 in cash in settlement of any claims on petitioner's property which she might have by reason of the marriage relation. As in *Lansill v. Burnet*, 58 F. (2d) 512 (App. D.C.), the arrangement was only a convenient method of payment.

Not only did petitioner fail to make an assignment of his right to receive the income, but these agreements cannot even be interpreted as limiting payment to income. If the trust income should prove inadequate the deficit would either have to be paid by petitioner out of his personal funds, or would have to be paid out of corpus of the estate when petitioner received his share.

In this connection it should be noted that the order to the trustees, if any was given, was not

offered in evidence. Also, the contract of December 21, 1925, provides (R. 44) that the—

* * * contract of December 11th, 1924, will be novated and reformed by the elimination of all of paragraphs 5, 6, and 7, and the copy of said contract now on file with the Fulton Trust Company of New York will be withdrawn and another contract executed and filed in its stead in accordance with the stipulation herein.

Yet no “novated and reformed” contract was offered in evidence. This is significant. Under the circumstances it is only reasonable to assume that if either the order to the trustees or the novated contract contained language more clearly indicating an intention to make an assignment of the right to receive income they would have been introduced in evidence or their terms explained.

In *Bishop v. Commissioner*, 54 F. (2d) 298 (C.C.A. 7th), where the taxpayer had failed to introduce in evidence the contract upon which the assignment was based the court said (p. 301):

Another reason which must preclude petitioner's recovery is that the burden of establishing error in the Board's finding is upon him. It will be observed that the assignment is made subject to the conditions of the contract existing between the company and petitioner. That contract is not in the record, and hence we have no way of knowing what sort of title to the commissions was

given to the wife. For aught we know that contract may prevent an absolute assignment. Anything less than this would be sufficient to defeat petitioner's claim.

If we assume, however, that no "novated and reformed" contract was executed, and no written order given to the trustee, it is obvious that paragraph 7 of the contract of December 11, 1924, cannot be considered as entirely eliminated. Clearly the modifications of December 21, 1925, and February 2, 1926, contemplated performance of that part of paragraph 7 which called for the payment of \$400,000 in cash by the petitioner. Under all the circumstances we believe the Board properly held that these agreements provided for nothing more than a method of convenient payment by the petitioner, and that petitioner neither made nor intended to make an unqualified assignment of his right to receive the income in the first instance. Accordingly, the amount involved was properly included in petitioner's income by the Commissioner and the Board of Tax Appeals. *Power v. Commissioner*, 61 F. (2d) 625 (C.C.A. 8th), certiorari denied, 288 U.S. 612; *Corliss v. Bowers*, 281 U.S. 376; *Mitchell v. Bowers*, 9 F. (2d) 414 (S.D. N.Y.), affirmed, 15 F. (2d) 287 (C.C.A. 2nd), certiorari denied, 273 U.S. 759; *Winder v. Commissioner*, 17 B.T.A. 303.

CONCLUSION

The decision of the Board of Tax Appeals is correct and should be affirmed.

Respectfully submitted.

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